
Stretching the Federation

*The Art of the
State in Canada*

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Foreword

The Institute of Intergovernmental Relations at Queen's University has a mandate to undertake research and to stimulate debate about federalism in Canada and abroad. We are pleased to publish this set of papers and commentaries because they contribute significantly to this debate.

Stretching the Federation is an appropriate title for papers that confront issues around decentralization in Canada. As usual, however, not only is there substantial disagreement about the direction in which the Canadian federation is and should be evolving, but there is also considerably more complexity in the situation and in what is at stake than is first apparent. So the participants at this conference have done us the service of stretching our understanding.

Many of these participants also have practised "the art of the state." It is an extraordinarily distinguished group that was assembled to discuss the issues raised in the papers reproduced here. This collection is unusual in its practical focus and its success in bridging the gap between academics and practitioners.

Hence, the Institute is pleased to publish these contributions.

Harvey Lazar
Director

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Introduction

ROBERT YOUNG

The papers and commentaries gathered here were delivered at a conference in October 1997. Some time has passed since then, and some important events have occurred in Canadian federal-provincial relations – especially the conclusion of the social union agreement in February 1999 – but the material in this volume remains highly pertinent. First, some of the big themes tackled here transcend recent events and even Canada: such is the case with globalization and territory, and with the ideological direction of decentralization. Second, some papers provide background information on the stakes at issue and the strategies of various governments. This is true of analyses of tax systems and of overlap and duplication in the federation. Finally, some authors and commentators are still well "out front" of events, making suggestions about reallocating expenditures and taxation powers and predictions about health care which may or may not materialize. Academics have often made important contributions to the practical evolution of Canadian federalism, and the papers presented here certainly continue that tradition.

In many ways, the conference at which these papers were delivered sprang from one such contribution by an academic, Thomas J. Courchene of Queen's University. In the context of severe provincial discontent with the federal government's unilateral cuts in transfer payments, Courchene wrote a paper (1996a) called *ACCESS: A Convention on the Canadian Economic and Social Systems*, for the Ontario government. This paper built on ideas about more decentralization, clearer roles and responsibilities, better federal-provincial cooperation, and improved service delivery that had been circulating for some time and that had been given more momentum by the near victory of the sovereigntists in the 1995 Quebec referendum (Young, 1999: 87-122). They had also gained impetus with the dissatisfaction of the wealthier provinces – Ontario, Alberta, and British Columbia – about federal unilateralism and cuts in transfers. Tom Courchene's *ACCESS* paper, discussed at the 1996 annual Premiers' Conference, added more impetus. His

first ACCESS model described a framework agreement for more decentralization from Ottawa and much better federal-provincial coordination. The second, more radical model laid out a system where a great deal would be done in Canada through interprovincial cooperation.

Throughout 1996 and 1997, the provincial governments' orientation expanded from a limited social agenda to a broad framework agreement on the "social union." By December 1997, Ottawa and all the provincial governments – except that of Quebec – agreed that this would involve fundamental social policy principles (such as mobility and program monitoring), "collaborative approaches" to using the federal spending power, dispute-settlement mechanisms (which had been a major part of Courchene's ACCESS proposals), rules for intergovernmental cooperation, and more clearly defined roles and responsibilities for the two orders of government (Canadian Intergovernmental Conference Secretariat, 1997). The sovereignist government of Quebec at first refused to participate, then did so as of September 1998 (Young, 1999: 148-50). In the end, however, Premier Bouchard could not sign an agreement that failed to provide compensation when provincial governments chose to opt out of new federal initiatives in areas of provincial jurisdiction.

The agreement itself is a significant document, though much will depend on its implementation and evolution (Canadian Intergovernmental Conference Secretariat, 1999). It contains a statement of general principles – rather like the Social Charter proposed for the Charlottetown constitutional accord – and stresses mobility rights and the need for social programs to be transparent, open to participation, and properly monitored. There are requirements for consultation and advance notice of new initiatives. Ottawa's spending power is constrained by provisions that it must consult with the provinces before altering transfer levels or launching new programs (especially ones supported by transfers, which would require a majority of provinces to concur). Finally, there are provisions for dispute avoidance and resolution (including mediation), and for a full review of the framework agreement by the year 2002.

The social union agreement is an important step, but it is only one element in the rapid evolution of Canadian federalism. Here, that evolution is set in its global context by Michael Keating, a specialist in comparative politics. His paper is a sweeping overview of the changing relationships between territory and function in a world of very rapid economic, social and political change. Apart from stressing the enormous variety of governmental forms and intergovernmental relations in the world today, and particularly in the European Union, Keating finds common ground in the complexity of governance in these systems and, relatedly, in the continuing relevance of territorial and regional organization. (As Ronald Watts's careful comments show, complexity and variety are remarkable features of modern federal governance; indeed, those interested in careful documentation and analysis

of these features could profitably examine Watts's own recent [1996; 1999] comparative works.) On the normative front, however, Keating is not terribly sanguine. Some current trends, such as greater economic and political competition, pose new challenges to principles of equity, human rights, and democracy, as well as to governments' efficacy.

The next paper, by Evert Lindquist, moves deep into the guts of governance in Canada, as the author seeks out overlap and duplication in the system. First, though, Lindquist provides a useful analysis of types of overlap, and advances a life-cycle theory of administration; these considerations suggest that one should find very different patterns across different policy fields. And this he does find, in four original case studies of dense networks of committees managing rapidly changing policies. The commentator, Peter Meekison, adds another useful distinction, between policy fields that involve expenditures and those involving regulation, and this could help explain some of Lindquist's results. Both author and commentator agree, however, on the need for all governments to explain to their citizens both how the system functions and how it is being improved. This is one objective of the social union agreement's provisions about monitoring and transparency, and Lindquist's study of overlap shows how important is this goal.

The next paper, by Paul Boothe and Derek Hermanutz, flows directly from the ACCESS proposals. It presents an accounting of the jurisdictional and fiscal implications of Courchene's schemes. This paper was described at the conference by Paul Boothe, too modestly, as an exercise in "plumbing," but it is much more than this. Harvey Lazar's comments clearly lay out how much political and even philosophical baggage is stashed in the authors' assumptions and methodology. In any case, having sorted out the overall implications of ACCESS in previous work (1997), Boothe and Hermanutz here calculate the results of reallocating functions and tax powers for each province individually. Very large changes in governments' responsibilities and tax bases might produce surprisingly small shifts in the balance of power between the two orders of government.

Among all the authors here, Antonia Maioni is the most sceptical about decentralization. In analysing a possible health-care system where Ottawa has largely vacated the field to the provinces, she applies some lessons from international relations theory to suggest that the various provinces could not cooperate sufficiently to maintain Medicare as we know it. The system would erode in the absence of a hegemon – the federal government – with the power to enforce rules and to provide incentives for coordinated behaviour. John Richards took issue with aspects of this analysis, and favours decentralization on balance, but he is no less sceptical about interprovincial cooperation. Professor Maioni's paper is interesting in another respect. She pays close attention to the distinct character of health policy in Quebec, and this shows the extent to which that province is a policy outlier, and also how it is tolerated as a "free rider" (which might also occur within the new social

union framework).

The longest paper in this collection is by Tom Courchene. Having inspired the rest of the contributions, directly or indirectly, through ACCESS, this restless scholar had moved on to new terrain, typically. His paper analyses the advantages and disadvantages of Ontario establishing its own personal income tax (PIT) system. It contains a valuable description of how the system works now, and of how Ottawa seems to have a first-mover advantage in the tax game because it controls the definition of the PIT base. Courchene then rehearses the costs and benefits of change, and finds new rationales for a separate Ontario system in the province's economic evolution, federal policy irritants, and Ottawa's abandonment of stabilization. This whole analysis may seem dated by the federal government's policy shift towards collaborating with the provinces on tax matters through a new Canada Customs and Revenue Agency. But it is not. Courchene's work clarified the issues, added to the pressures on Ottawa, and may show how intellectuals can make a difference at the margin by diagnosing that a system is on the verge of shifting to a new equilibrium. In any event, contending positions in this debate (and others) are illustrated by the two commentators. William Robson sees as minor the costs and benefits of a separate Ontario PIT, but he thinks the prospect provides a very substantial threat power against Ottawa, and suggests the province could use this to extract from the federal government something really desirable. France St-Hilaire, in contrast, thinks that much is at risk and that before using the "heavy artillery" of a PIT withdrawal, the Ontario government should concentrate on cooperating to achieve progress within the system. Hard choices indeed.

The final paper here is by Alain Noël, who addresses the broad question of whether decentralization is conservative – and inherently so. This is a very difficult issue, and Noël approaches it by identifying several arguments against decentralization and analysing them in light of the evidence. Here he makes an especially powerful case against the "systemic" argument that intergovernmental competition leads to a "race to the bottom" in social policy (through dynamics traced in part by Maioni). He also sets decentralization within current efforts to rethink the traditional welfare state, a context captured well by Stephen Brooks's comments about the sources of resistance to decentralization. Noël makes a good contribution to this progressive rethinking, showing how decentralization might lead not to regressive policy changes but to a new emphasis on local communities, empowerment, and democracy.

So, all in all, this is a highly diverse set of papers, but their *foci* overlap and highlight several themes – the strength of territorially rooted communities, the complexity of governance in modern federal states, the prospects of decentralization in Canada, the resources of the provinces in promoting it and of Ottawa in maintaining its prerogatives, and the ability of governments to cooperate and collaborate, both vertically and horizontally. As the

conference rapporteur David Cameron notes in his brief concluding section, the papers and the conference span the range from the largest questions of comparative government to the micro-politics of particular Canadian programs. But all these papers are about stretching the federation and enlarging our understanding of Canadian federalism.

Challenges to Federalism: Territory, Function, and Power in a Globalizing World

MICHAEL KEATING

FEDERALISM AND GLOBALIZATION

The federal principle as a mechanism for dividing and sharing power has never been so widely applied as at present. Yet changes in the role of the state, in the international arena, and in the relationship between state and economy, along with the growing complexity of government, bring into question traditional models of federalism. The relation between territory and function remains a key element in the understanding of modern government, but this has been changing in important ways. The paper reviews these issues in comparative perspective, drawing extensively from the experience of Western Europe, where the most radical restructuring of territorial government has taken place.

THE FEDERAL PRINCIPLE

Federalism has been defined and interpreted in many ways. Everyone is agreed that it is about dividing and sharing power and responsibilities, but for some it is strictly confined to a form of government and rooted in constitutional principles, while others interpret it more broadly as a principle or social organization extending into civil society and even the private sphere. In this paper, I take a rather restricted definition, seeing it as a principle for dividing government, by territory, function and constituency (Maass, 1959), into two tiers, each sovereign within its own competences. Even confining the term to the institutions of government, we find many variations on the federal principle, with two main ideal types. The first, broadly associated with constitutional practice in the United States since the early nineteenth century, is based on the doctrine of separation of powers and rooted in the tradition of limited government and countervailing powers. There is no conception of the "state" as an entity in its own right, but only of "government,"

itself rooted in Lockian notions of contract and consent, and strictly limited in its scope. Each tier of government has its own constitutionally entrenched competences, with the full range of executive, legislative, and judicial institutions. The second conception of federalism, associated with European, and especially German, practice, is rooted in the tradition of a strong and pervasive state with wide powers of social regulation and organically connected with civil society. Constitutionalism exists here not to limit the scope of the state but to regulate its operation and govern the relationships of its constituent parts. Powers are not divided between tiers, with each sovereign within its own sphere, but shared, with a high degree of interpenetration and cooperation; there is similarly a strong interpenetration of state and civil society, which in the twentieth century has given rise to various forms of corporatism or neocorporatism. So German *Länder* do not legislate much independently, but have an important role in the federal legislative process through the *Bundesrat*, representing Land governments. Similarly, they have few independent fiscal powers, but federal finance laws must be approved in the *Bundesrat* and so effectively negotiated with the *Länder*.

In the modern era, there has been considerable convergence of the two types within the liberal welfare state. In the United States, especially since the New Deal of the 1930s, there is a great deal of overlap, cooperation, and joint policy making between the levels (Wright, 1988). In Germany, the tradition of a strong and pervasive state has weakened in the face of liberalism and individualism. Yet the basic distinction remains valid and provides a guide to political practice. The American doctrine of states' rights has never died, constitutional amendments are difficult and rare, and government remains limited in its scope. German political practice is still marked by cooperation and consensus-seeking, by corporatism and intergovernmental policy-making.

At one time, it was common to make a distinction between regional government, which was a mere devolution of power from the centre, and federalism, in which the constituent units have their own entrenched powers. The distinction was more useful in North America, where federalism rests on a clear division of competences, than in Europe, where federalism had a more integrated and unitary character. Nowadays this distinction is becoming ever less relevant on both sides of the Atlantic, as federations have moved into complex patterns of interdependency, while regional governments have gained in functional competence and political standing (Mariuca, 1995; Roccella, 1996). The Spanish constitutions of 1932 and 1978 attempted to find a middle ground between regionalism and federalism through the formula of the *Estado Integral*¹ (in the 1930s) or the *Estado de las Autonomías* (in the present constitution), but many observers consider that Spain is heading towards an effective federation (Moreno, 1997). It might therefore be useful to categorize states with entrenched territorial governments as "established federalism"; "emerging federalism," where federal-type institutions

are developing; and "potential federalism," where current trends indicate that federal arrangements may emerge.

Table 1
Federal States in 1997

<i>Federalism</i>	<i>Emerging federalism</i>	<i>Potential federalism</i>
Switzerland	Spain	Italy
Canada	Ethiopia	United Kingdom
United States of America	South Africa	
Germany	European Union	
Belgium		
Austria		
Malaysia		
Australia		
Mexico		
Brazil		
Argentina		
India		
Russia		
Nigeria		

These arrangements can further be divided on two dimensions: the autonomous power of subnational governments, and the influence of subnational governments in national policymaking. So Canada and Switzerland are states in which the federated units have a large degree of autonomy, but in Canada the provinces have no formal role in national policy making. In Germany, on the other hand, the Länder have limited autonomous legislative power but have an effective veto over the majority of national legislation through the Bundesrat. Canadian provinces have extensive fiscal autonomy, unlike German Länder, but the Länder have a direct voice in national taxation and the distribution of money among the three levels (federal, Land, and municipal). Given the interlinking of policy spheres in present-day policymaking, the presence of subnational representation in national policy forums is a key issue, and one with which Canada has been grappling through the institution of the First Ministers' Conference.

Federalism, as well as being a mechanism for limiting and sharing power, is a means of managing diversity, but the territorial units may be more or less distinct in their politics, culture, and social and economic basis. Some federated units are historically or culturally distinct, or have a past as independent states, as with Quebec or the historical nationalities of Spain. Others have been constructed for reasons of political convenience or historical accident, as with most of the German Länder. Some units constitute homogeneous economic regions, or functional regions characterized by a range of

complementary activities and interdependencies. There are limits on the ability of federalism to accommodate diversity, since the various criteria do not often coincide. There are, in particular, limits on the usefulness of federalism for managing ethnic diversity and conflict. Ethnicity, even if it is possible to decide just what it is, rarely coincides with geographical boundaries. Drawing ethnic lines on maps, apart from any moral reservations it may evoke, serves merely as an invitation to groups to advance ethnically based claims. So federalism cannot in itself resolve the problems of divided societies, like Northern Ireland. Even where ethnic groups are physically separated, there are always minorities on the wrong side of the line, as in former Yugoslavia. Ethnicity as a basis for federalism may itself be destabilizing, as shown in the history of Nigeria. A territorially based civic identity, in which everyone within the territory, including immigrants, is deemed to belong, is another matter and does provide a mechanism for peacefully managing diversity.² Nor is federalism much used as an instrument of linguistic partitioning, with the notable exception of Belgium, and even here there is a large exception in the case of Brussels. In other cases, there may be dominant language groups in some jurisdictions but the boundaries do not coincide (as in Catalonia and Quebec), or a language boundary traversing the state may leave most but not all jurisdictions wholly on one or other side of it (as in Switzerland).³ In these cases, each jurisdiction has a majority language, but this is a very different matter from establishing linguistic monopoly. In other cases, the language group may be a minority within its own territory, but nevertheless given special recognition because of their historic rights (as in Wales and the Basque Country). So federalism may thus help manage ethnic and linguistic diversity, by providing units in which a particular group is in the majority, but unless the units themselves are tolerant of their minorities, the system is likely to be unstable.

Federal stability is also secured by two other elements – an overarching loyalty to the nation and political system, and territorial political exchange. Diffuse loyalty to the political system is achieved by shared national identity, values, and symbols, and a general constitutional allegiance and commitment, which the Germans call *Bundestreue* (federal loyalty) and which is a legally enforceable principle (Leonardy, 1996). Some scholars emphasize the sense of shared national identity as a critical element in holding together any political system, concluding that a European federation is unlikely to come into being because Europe lacks a sense of common nationhood (Smith, 1995). Others note that federalism is precisely a system for managing diversity and argue that all that is required is a set of common values and commitments. This argument parallels the debate in Canada. On the one hand are those who insist that there is only one Canadian national identity and that Quebec must accept this or leave, echoing the insistence of Quebec nationalists that national identities are singular and exclusive. On the other hand are those who argue that federalism is capable of encompassing dis-

tinct identities, as long as there are some common values and a commitment to make federalism work. This raises the question of what the common values are.

Territorial political exchange refers to the exchange, of loyalty to the regime or support for the government in power, against policy concessions, notably on fiscal and economic matters, but also on cultural and political autonomy. This is a feature not only of federal states but also of unitary and decentralized ones, the mechanisms of the exchange differing from case to case (Keating, 1988; 1998). In the nineteenth-century state, the main instrument was national tariff policy, adjusted to satisfy powerful territorial as well as sectoral interests. So the unified German state after 1870 saw the iron and steel alliance, while in Italy the interests of the southern landowners and northern industrialists were reconciled through tariff policy. In Spain, the Catalan bourgeoisie was as keen on national tariff protection as on local self-government, while in the U.K. free trade represented the victory of the industrial trading regions. In Canada, tariff policy was used to unite the country by forging an east-west economic axis, albeit at the cost of recurrent western discontent. In the postwar welfare state, a principal instrument of territorial exchange was regional development policy, especially during the 1960s when it could be sold as a non-zero-sum policy within the national context.⁴ The national welfare state played an important role, redistributing large amounts of resources interregionally (in the guise of interpersonal transfers) and providing an automatic stabilizer in the event of asymmetrical shocks, since regions in recession would automatically receive more in welfare payments and pay less in taxes.

A final feature of federalism is as a system of horizontal policy integration. Policy can be tailored to meet the needs of distinct territories. Diverse functional responsibilities can be brought together and coordinated for maximum policy impact and effectiveness. Dialogue and cooperation between government and the territorially based social partners can also permit a better appreciation of local problems and better policy impact. In this perspective, the federal division of powers is not seen as a zero-sum game in which any gain for one level is a loss for another. Rather, both levels can gain power, in the sense of a capacity to address social and economic problems, simultaneously.⁵

PRESSURES ON FEDERALISM

Federalism has come under increasing pressure in the modern state. Constitutionalism and legal delineation of powers and functions fit ill with the changing demands of modern government and the shifting policy tasks of the state. Government functions underwent a radical change after the Second World War with the rise of the welfare state, which led to an expanded role for national governments in redistribution and the definition of stan-

dards in social provision. The enhanced role of government in economic stabilization in the era of Keynesianism had the same effect. In the United States, the federal division of powers was challenged in the 1930s and 1960s by expansion in the role of government, national market regulation, demands for nationally enforceable civil rights, and the needs of national welfare provision. Some flexibility has been introduced by the generous interpretation of federal power, especially the spending power and the power to link allocations to priorities in other fields.⁶ Vertical policy communities developed, linking federal, state, and local government so that "layer cake" federalism, with horizontal integration and clear division of powers, was replaced by "picket fence" federalism, marked by vertical policy communities spanning the various levels of government. Even more complexity was introduced by the presence of independent federal and state agencies, to produce the confusing mass known as "marble cake federalism," lacking in clear lines of authority and integration, whether vertical or horizontal. The complex system of intergovernmental relations was sometimes referred to as a separate branch of government in itself. The European federal model, less dependent on strict delineation of powers and more attuned to a strong state role, has fewer problems here, and German federalism expanded its cooperative elements with the Joint Tasks provision (*Gemeinschaftsaufgabe*) and the understanding that the *Länder* would limit themselves largely to policy execution, within a national legislative framework.⁷ In the European Union, which many see as an emerging federation, there is no defined allocation of competences at all. Instead, the treaties list policy goals and attribute powers to institutions to achieve them (Forsyth, 1996). The result is a very flexible system, but one which potentially encompasses just about everything, since the core economic competences are so far-reaching (Sharpf, 1996). Indeed, so far-reaching is the potential scope of the EU that some member states have recently reacted against what they see as excessive Commission activism and sought to define Union functions more tightly. In general, across federal and regionalized systems, the emphasis has shifted from the division of powers to the needs of policy effectiveness.

In the 1990s, federalism faces new challenges from the attenuation of the connections among territory, function, and political power. In the economic sphere, globalization of production has loosened the link between production and location and allowed owners of capital to scour the world for the most profitable sites, reducing governments often to the role of soliciting investment. A coherent project for territorial development or a dialogue between government and business is rendered more difficult because of the imbalance of power between territorial governments and capital, leaving business free to choose its own location and demand the minimal services it requires. In the cultural sphere, globalization, through U.S. cultural hegemony and the effects of modern communication technology, may break down local cultures and identities. In the political and social spheres, the

individualization of social relations and weakening of collective institutions and forms of behaviour militates against a sense of territorial identity and solidarity. New social movements have emerged, but these are defined by criteria such as ethnicity, gender, or ideology which are non-territorial in their social base, and whose demands transcend territorial divisions of government, whether within or among states. These processes have attenuated the link between function and territory, which underlies the federal constitution, and have undercut the social basis for territorial politics, for sub-state institutions and a federal division of power. Some observers have gone so far as to talk of the "end of territory" as a force in social and political life (Badie, 1995).

Global economic change, the advance of markets, and the rise of transnational regimes have undermined the political economy of federalism and with it much of the basis for territorial political exchange put in place in the last century. Independent tariff policies are now ruled out by global and regional free trade regimes, while regional policies are undermined by the international mobility of capital and the concentration of states on the promotion of national competitiveness at the expense of regional balance, as well as by fiscal strains.

The rise of regional (interstate) free trade regimes has also destabilized territorial relationships, notably in North America under NAFTA and within the European Union. These regimes increase the market exposure of regional economies and reduce the ability of the national state to protect them, thus devaluing the importance of intergovernmental links with it, while encouraging competition among subnational units. They also impose new policy requirements on subnational governments, which are subject to policies made within the free trade regime, and may even have to implement them, without having an input into the policy-making process.

This has all reduced the role of the state in territorial management, and undermined systems of territorial representation and exchange. Cooperation has given way to competition, within the state, within international regimes, and in the global market place. National governments have in some cases compounded this by offloading responsibilities to lower tiers and decentralizing fiscal responsibilities, for example in the United States and Canada. This is not, as sometimes thought, a universal trend, but depends on the power of the federated units within national political systems. In Germany the strong role of the *Länder* in the federal system has enabled them to push the burden of adjustment, including the bill for reunification, up to the federal level. Spanish autonomous communities have forced minority national governments to make important fiscal concessions, while in Belgium the regions and communes have secured guaranteed revenues.⁸ Ironically, it is in the most fully decentralized federations that national governments can push more of the fiscal burden onto the lower tiers, since these have their own fiscal powers and can raise taxes or cut services to balance their books

or, in the case of Canadian provinces, run deficits. In those more integrated systems, where subnational governments have less policy autonomy but more say in national policy-making, they are better able to resist fiscal off-loading.

THE REINVENTION OF TERRITORY

We need to be careful about the "end of territory" thesis. One cannot reason directly from functional restructuring or economic processes to political power and governing institutions, without giving an independent role to politics, a role which varies from one case to another. The end of territory is a constant theme of modernization theorists, from Durkheim (1964) in the late nineteenth century, through Deutsch (1966) and the post-Second World War diffusionist school, to Badie (1995) and the postmodernists. Territory is consistently presented as something specific to premodern, or underdeveloped societies, which will disappear under the inexorable pressures of economic change, cultural diffusion, and individualism. Earlier modernization theorists saw the end of territory culminating in the consolidation of the homogeneous nation-state, often ignoring the fact that the nation-state is itself a territorial configuration. Nowadays, the end of territory is seen as synonymous with the end of the nation-state as we have known it in the last 120 years or so, on the assumption that it constitutes the sole framework for territorial politics. Yet today, in the face of all the forces apparently undermining the territorial basis for politics and government, the territorial principle for organizing government is not only surviving but extending. Powers are being decentralized in the United States and Canada. In the European Union, a federal-type political order is emerging, although there is a remarkable lack of consensus among political scientists as to its nature or even what to call it. Belgium has been transformed into a federal state in the 1990s, Spain and, more recently, the United Kingdom are moving piecemeal in the same direction, and there are proposals for a federal constitution for Italy. Within European states, regions are being recognized as a key level of government, administration, and political mobilization. Elsewhere in the world, federalism is being reinvented but not suppressed. So, as in the past, we are seeing not the end of territory but its transformation and reinvention in new forms.

Indeed, despite all the pressures of globalization, of markets and of social individualism, politics always seems to come back to a territorial basis. There are powerful theoretical reasons why this should be so: functional, political, and normative.

Even in an era of globalization and individualization of social relations, there is a territorial basis to functional restructuring, but that link has been transformed in important ways. There is a large literature documenting the importance of territory to economic restructuring within the global economy

(Storper, 1995) showing that, while the importance of location in some respects (for example, proximity to raw materials or waterways) is diminishing, in other ways it is increasing. New modes of production involve intricate patterns of interdependency, including both traded interdependencies such as the relationship between producers and just-in-time components suppliers, and untraded interdependencies in the form of public goods such as research and development, the physical environment, shared expectations, and social trust (Storper, 1995; Courchene, 1995a). These permit firms to exploit external economies of scale in a manner reminiscent of the industrial districts of the nineteenth century. Some regions, with the right mixture of factor endowments and social practices, are able to construct a virtuous circle of development and growth, in which social cooperation generates rewards, which encourage further cooperation and serve to legitimate social practices; others are trapped in a vicious circle in which lack of cooperation leads to stagnation and defensive behaviour, lack of trust, and further decline. So territory, far from disappearing, becomes itself an important factor of production, and this in turn has important public policy implications as governments search for the best mix of policies and institutions to foster the virtuous model of development. The role of subnational governments in economic development policies has also been encouraged by the decline of national regional policies and the competitive environment described below.

Territory is also a crucial element in the management of a range of other policies, some of which are inescapably territorial, such as the environment, while others are essentially personal but depend nonetheless on control of territory for their implementation, such as cultural and language policies. In fact, most public policies are non-excludable and so organized on a territorial basis. Territory is important also for functional integration and in the search for new and more effective functional linkages. For example, most states have in recent years decentralized training and manpower policies in order to make them correspond better with labour market areas and to coordinate them with regional development policies on the one hand and education on the other. In this functional restructuring, the region has emerged as a key level of integration and public action.

This does not mean, *pace* writers such as Ohmae (1995), that politics will follow, or that we are heading to a world of "regional states." Politics is an independent force and, whatever the functional pressures, they do not automatically produce a particular political result. Yet, as it happens, politics too is tending to decentralize and to regionalize and it too has a tendency to adopt a territorial basis. Territory provides the most convenient and effective basis for political mobilization, even in a world of mass and instantaneous communication, so that all political parties and most social movements are organized territorially. It also provides a focus for political demands and their aggregation and, in a world of weakened class identities, may furnish an important base for social solidarity. Ethnic and nationalist movements

will usually seek a territorial basis if they do not already possess one, as a foundation for claims to self-government. So we see in the cases of Quebec, Flanders, and the Basque Country a movement from ethnic or linguistic mobilization to the construction of a territorial nationalism as the most effective vehicle for achieving autonomy. Territory, for these purposes, is not a given or a mere residue of premodern society, but is constantly being defined and redefined in the modern era. So Flanders, from being the name of a province in the Low Countries, has been extended to cover essentially the whole of Dutch-speaking Belgium, while Euskadi has come to be defined as the common territory of the three Basque provinces which come under the Basque autonomous government, replacing earlier conceptions which defined the Basques by language or ancestry, or which rooted political demands in provincial traditions and rights. Other efforts at territorial reinvention have been less successful, as witness the efforts by the Lega Nord in Italy to garner support for the region or "nation" of Padania (Mannheimer, 1991; Biorco, 1997), or the attempts in the 1970s to use Occitania as a basis for an autonomist movement and set of policy demands (Touraine et al., 1981; Keating, 1985).

Normative reasons for politics to be brought back to a territorial basis arise from the fact that territory provides almost the sole basis for political representation and accountability in liberal democracies. Non-territorial forms of representation – for example, through consociational accommodation or corporatist intermediation – have been in decline in recent years, partly because of their inefficacy in the face of global change and the transformation of the state, but also because of their non-democratic and non-participatory nature. Territory also has the virtue of being an inclusive principle of political organization, allowing all residents of an area equal rights, irrespective of their ethnic or other ascriptive characteristics. Of course, the reference group for representation and decision-making will vary according to how the boundary is drawn, so that territorial definition is a matter of political conflict and debate.

These tendencies to the territorialization of politics do not all point to the same territorial delimitations or institutions. Functional requirements may conflict with felt identities or with the needs of democratic representation. Functional requirements themselves may conflict. Ohmae (1995) predicts the inexorable rise of "regional states" on the basis of economic restructuring, but only by assuming a rigorously neoliberal trading order and dismissing questions of social solidarity, democratic government, and cultural expression as a tiresome irrelevance.⁹ Others have argued the need for self-government with little regard for functional viability. There is certainly a tendency for politics to territorialize, but the construction of territorial systems of action depends on political action and leadership, producing different projects in different places. Rather than a new territorial hierarchy, we have a complex pattern of political mobilization and institution-building,

based on different conceptions of territory and function. This makes it difficult to apply the federal principle of division of powers in the present era.

THE NEW TERRITORIAL POLITICS

Four features in particular characterize the new territorial politics: competition, the changed context, complexity, and asymmetry.

Competition

One of the most striking features of contemporary regional and federal politics is the emphasis on competition. This is partly a matter of objective reality, partly a matter of political presentation. Capital mobility has made regions increasingly vulnerable and has posed the need constantly to attract and retain investment. Thinking about regional development now emphasizes the qualities of territories as a factor in growth, and the old notion of comparative advantage, which permitted an optimum allocation of resources and presented regions as essentially complementary, has given way to the idea of competitive advantage, seen as absolute rather than comparative, in which regions are engaged in a war of all against all. Politicians have encouraged this notion and perhaps stretched it beyond its proper limits, since it provides a mobilizing theme which enables them to appeal to the whole local electorate, postulating a common interest and identifying a common external enemy. Competition and stressing the territorial interest has thus become a dominant theme in much of regional politics, producing a neomercantilist form of politics in which regions are pitched against each other in a zero-sum game. The political agenda is transformed, with development issues given a privileged place, often at the expense of social solidarity and redistribution. As competition comes to dominate federal relations, the cooperation and accommodation that we have identified as essential features of modern federalism come under strain. Even in Germany, the old regulated and negotiated order is giving way to a competitive ethos (Deeg, 1996; Sturm, 1997). In Australia, competitive regionalism has been encouraged by government policy (Fulop, 1997).

A second dimension of competition arises from the existence of governments competing with each other to provide services or satisfy needs within the same territory. Many recent accounts of federalism, generally influenced by public choice theory, place less emphasis on coordination and cooperation as the basis for efficiency, and more on competition (Martinelli, 1997). Dente (1997) argues for three types of federalism, corresponding to three models of problem and problem solving. In conditions of stability, where both problems and solutions are known, classical federalism based on the division of power is appropriate. In the modern state, where the problem is known but the solution unknown or complex, cooperative federalism has

emerged. At the end of the twentieth century, however, where neither problems nor solutions are clearly identified and understood, Dente argues that competitive federalism, with a capacity for experiment and comparison, may be appropriate. Overlapping jurisdictions and redundancy are seen, from this perspective, not as a problem to be eliminated but as a useful way of securing spare capacity for innovation.

Context

The decline in the regulatory capacity of federal states, notably the lessened emphasis on fiscal equalization and the decline of centrally directed regional development policies, has encouraged this competition. The context of competition has been extended beyond the national state, into the free-trade regimes such as NAFTA and the EU, and the global market. So the old bilateral territorial exchange has given way to more complex forms of exchange, involving states, regions, international regimes and the global market, and mediated both by political influence and by competitive market advantage.

This new context has eroded the boundary between domestic and foreign policy and produced new forms of paradiplomacy, as regions seek out opportunities abroad (Keating, 1997b). The new forms of subnational activity abroad do not constitute an alternative to traditional diplomacy or foreign relations, since they tend to be functionally specific and focused on particular targets, but they do challenge the monopoly of the state in external representation. Regions have three principal concerns in going abroad – economic, cultural, and political. Economic initiatives are aimed at securing policy advantages in international regimes, attracting inward investment, securing markets for local products, and gaining access to new technology. Cultural motives are important for culturally distinctive territories such as Quebec, Flanders, or Catalonia, which seek in the continental or global arena support for their cultural development which is not always forthcoming in the state arena. Broader political motivations, which are most important in, but not confined to, territories with national aspirations and nationalist movements, are concerned with the external legitimation of the nation-building or region-building project, and with securing allies and building coalitions of regions with similar interests across national boundaries. Targets of external action vary according to the action in question and the nature of the territorial project. Most common are links with other subnational governments, but where there is a nation-building project under way, as in Quebec or Flanders, there is more of a focus on national governments. Much work is also done in collaboration with the private sector, through public-private agencies or government-sponsored business associations like Catalonia's Patronat Català Pro Europa. In the EU, many regions have established offices in Brussels, and Canadian provinces and U.S. states also have delegations abroad.

Free trade regimes pose both economic and political challenges for regions and federated states. According to neoclassical economic theory, they will deliver benefits to all by improving allocative efficiency and exploiting comparative advantages. In a world in which regions are seeking absolute competitive advantages, however, there are likely to be winners and losers. Furthermore, the welfare gains from free trade can be realized only if there is flexibility in labour markets such that resources released from one sector or region can be re-employed in another, a condition which rarely holds in practice (Dunford, 1994). So free trade in Europe and North America has further stimulated the search for competitive advantage and caused regions to look to their own efforts. It has also deepened territorial cleavages as dominant political forces within particular regions have perceived their own region as a winner or a loser. Politically, the creation of free trade regimes subjects subnational governments to market disciplines and public policies decided in interstate negotiations, even in matters of their own competence. The effect in Europe of the 1970s was that, as the common market deepened and peripheral regions were faced with increased competition, there was increased opposition to the European project. Since the late 1980s, this opposition has tended to give way to active engagement in Europe, as regions seek to influence the emerging European polity. This protagonism of regions within the Community institutions has spawned a considerable literature (Keating and Jones, 1985; Jones and Keating, 1995; Petschen, 1993; Bullman, 1995; De Castro, 1994; Jefferey, 1996). The main points of influence are through their national governments; through missions and lobbies around the Commission in Brussels; through the European Parliament; through partnership arrangements in the implementation of Community regional policy; and through the dense network of consultative committees, including the Committee of the Regions. Another area of activity has been cross-border cooperation, as regions seek to exploit complementary assets and common opportunities, or to combine their political influence in their respective states or in Europe (Balme, 1996).

Neither type of activity is as well developed in North America. NAFTA lacks its own political structures, its own law or a policy-making capacity, and so there is no obvious point of influence apart from national governments. Cross-border collaboration is made more difficult by the entrenched North American tradition of territorial competition exacerbated by the lack of regulation of investment subsidies. In contrast to Europe, there are no specific cross-border programs providing incentives and resources for partnership schemes, and the divergence in labour market regulation and social services makes it difficult to mount joint initiatives (Keating, 1996b).

Constitutional provisions allowing subnational governments to operate outside the country vary greatly. They are very restrictive in France and have only recently been relaxed in Spain and Italy. Germany has a more permissive stance, while Belgian regions and communities have full external com-

petences in all matters under their purview. The European Union has introduced provisions, notably in the Maastricht Treaty, to accommodate subnational governments. The main ones are the establishment of a consultative Committee of the Regions and a provision that a regional minister may represent the state in the Council of Ministers where matters of regional responsibility are under discussion. This provision is effectively limited to the federal states of Germany, Austria, and Belgium and is dependent on internal political agreement, but may in the future be extended to Spain, the U.K. and Italy. Paradiplomacy provides a new dimension to federalism, but it may have reached its limits as regions have realized its limitations and the advantages of working closely with their own national governments. Both Ontario and Quebec have closed most of their overseas offices, as have some European regions. Dreams of a "third level" of government in Europe, with the regions forming an integral part of a continental federalism, have faded since the early 1990s (Jeffery, 1996).

Complexity

A third feature of the new territorial politics is its complexity, as the link from territory to function, identity, and institutions is complicated and variable. Policy has retreated from institutions into networks, which span the public and private sectors and bridge the state and international system. There have been many attempts to conceptualize this complexity, none of which really succeeds. Many people have latched onto the term "governance", a word of sufficiently indeterminate meaning to cover an indeterminate reality,¹⁰ and which has now been stretched to cover most organized human activity. One element common to all meanings is that public policy and regulation are taken out of the control of constitutional government and given over to a complex of agencies answering to multiple constituencies. In this complexity, the federal division of power, in which a territorial government exercises determinate competences over a specific area and is answerable to a territorial constituency, can easily get lost.

Asymmetry

A final feature of the new territorial politics is asymmetry. There are marked differences in the demands for autonomy coming from different regions, stretching from national separatism, through the search for a third way between separatism and federalism (Keating, 1996a), to demands for a more decentralized federalism or for special status, to those favouring the status quo. Some territories, because of their historic characteristics and the political movements which have developed there, have an exit option, being able to threaten secession should their demands not be satisfied. Quebec and Scotland provide two of the clearest examples. At the other extreme, there is

an integrative regionalism which seeks to tie the territory more closely into the national system, overcoming the disadvantages of peripherality and marginality. Some regions have developed strong institutions and become the main reference point for political debate, while others have weak or ineffective institutions. Some regions have distinct civil societies, with their own cultural, professional, business, and other interest groups and a consequent high capacity for social self-regulation, while others lack these features. In some regions, the elements governing institutions, civil society, economy, and culture coincide in space, allowing the elaboration of a social project, while in other places these diverse social processes operate at different spatial scales. Regions also differ greatly in the competitive advantages which they possess in continental and global markets and in their consequent dependence on the central state.

Nation states have been reluctant in principle to concede asymmetrical constitutional arrangements, but in practice there is a great deal of asymmetry, both within individual states and in the European Union (Keating, 1997a). Spain has a complex constitution, which declares the unity of the Spanish nation but recognizes the diversity of the nationalities and regions that comprise it. In theory, all autonomous communities can attain the same level of competences, but there are different routes to autonomy, which allows the historic nationalities and a few others to maintain a lead. The Basque Country and Navarre have a special fiscal arrangement allowing them to collect their own taxes and pass on the balance to Madrid. German federalism is in principle symmetrical, but the economic advantages of the richer western *Länder* put them in a different category from the new *Länder* of the east, a factor of increasing importance as the old cooperative federalism gives way to more competition. Italy conceded special status for its peripheral regions after the Second World War, and proposals for constitutional change promise to safeguard these. Belgium has a complex system of federalism, with three territorial regions (Flanders, Wallonia, and Brussels Capital) and three language communities (the Flemish, the French, and the German), but while the Flemish region and language community have effectively merged, this has not happened on the French side. The arrangements for Brussels are particularly complex (Brassinne, 1994). The United Kingdom had a separate parliament for Northern Ireland between 1922 and 1972, and since 1999 has a legislative parliament for Scotland and an executive assembly for Wales. Even France has conceded a special status for Corsica. In the European Union, the U.K. and Denmark have been allowed to opt out of various provisions, including the single currency, the Schengen agreement on open borders, the common defence and security policy, and, at one time, the Social Chapter.

This complexity in territorial government is not new and in many respects recalls a premodern world in which secular, ecclesiastical, and economic systems of regulation overlapped in complex and varied ways. It was

the work of the modern state, in the period c. 1870 to 1970, to impose regularity and uniformity, whether through the unitary or the uniform federal state, but even in this era many peculiarities remained.¹¹ In the present era, the complexity and the asymmetries are again increasing, and this poses a series of problems for effective and responsible government.

ISSUES IN THE NEW FEDERALISM

Efficacy

The first set of problems in the new federalism involves policy-efficacy, given the lack of fit between policy making systems and constitutional arrangements. The territorial scope of regions or federated units is often too large or too small. Both are illustrated in Germany, where North Rhine-Westphalia divides itself into regions for the purposes of economic planning and development, while the city states of Hamburg, Bremen, and Berlin are cut off from their natural hinterlands and are too small to engage in effective planning. Of the regions of Europe, only a few, like Catalonia and Scotland, are both meaningful planning units and foci of political identity. In many Western states there have been complaints that the regions are too small for the needs of international competition and, more generally, that institutional forms no longer fit functional requirements. Yet if these forms are based on political communities, they cannot be redesigned continually to reflect new functional needs without undermining democratic debate and participation.¹² The political difficulties in merging small units in the name of functional efficiency are illustrated by the abortive merger between Berlin and Brandenburg, and the frustrated attempts to achieve unity among the Atlantic provinces of Canada. This political inflexibility of institutional forms, and the legal regulation of intergovernmental relations, often prevents the matching of form to function. The complexity of policy systems, which cross-cut jurisdictions and agency boundaries both functionally and territorially, also militates against policy efficacy. The "joint decision trap"¹³ identified by Sharpf (1988) as a feature of German cooperative federalism and EC policy making is exacerbated as policy systems become more complex and veto points proliferate. Competitive federalism further reduces the incentive to cooperate, unless such incentives are built into the system itself, as to some degree is the case in the European Union. If cooperation is becoming more difficult in Germany, with its homogeneous culture and tradition of consensus, it is even more problematic in Belgium, where the federal system must accommodate linguistic/ethnic differences and separatist tendencies. The deepening and widening of the federal principle, which now covers Belgium's relationship with the European Union, has increased the need for cooperation but at the same time rendered it more difficult to achieve.

Equity

The second set of issues concerns equity. Competitive federalism will benefit the best-endowed regions economically, those that are most important politically, and those with the ability to operate in diverse political and economic systems, for example, in the national political arena, in international regimes and in the global marketplace. Others will be reduced to dependants of the federal state. Competition and reductions in intergovernmental transfers also put pressures on the welfare state and may encourage a "race to the bottom" or what the Europeans call "social dumping," as regions cut social overheads in order to attract investment. Decentralization of the welfare state, as in the recent American reforms, serves to reinforce this tendency, which is why European social democrats and American liberals have tended to resist this. Southern U.S. states and some regions of Britain offer as their competitive advantage low taxes, a minimum of labour market or environmental regulation, and a union-free environment. This is not to say that the "sweat-shop economy" is the best path to competitive success since the region is almost bound to be undercut eventually by an even lower-cost producer somewhere else in the world. In the short term, however, less favoured regions may have no choice but to trade down, since they lack the resources to invest in the high-cost, high-valued-added approach of their richer rivals. The result of this interjurisdictional competition may be suboptimal for everyone, since the short-term incentives to politicians to cut costs to compete in the market may discourage investment in building social capital such as education, training, infrastructure, and a good environment. Regions can live for a while on accumulated social capital while cutting taxes and reducing public expenditure, but if they fail to replenish the social capital stock, they will be in trouble in the longer term and forced continually to trade down further. Fiscal decentralization and a reduced federal role also remove the automatic stabilizers which protect regions from asymmetric shocks by reducing the tax take and increasing social spending in the areas hardest hit. This is a problem for the European Union, which lacks a system of fiscal federalism, leaving regions highly vulnerable to the effects of market integration.

This is a live issue in Europe, where a number of provisions of varying efficacy seek to control it. EU competition policy is well defined, elaborate, and active and, unlike comparable NAFTA provisions, applies equally to sub-national governments, and the Commission has in recent years been quite vigilant in controlling subsidies paid out by local and regional governments. Their main target recently has been Germany, where the *Länder* have continued a rather active industrial and regional development policy, despite the reduction in the role of the federal government and other European national states in the field. EU structural funds offer compensation to regions which

have suffered from the effects of the internal market, and are increasingly oriented to encouraging regional and local entrepreneurship and indigenous development. The Social Chapter lays down minimum standards of labour market regulation and, after a British hold-out under the Conservatives, has now been signed by all fifteen member states. All this represents an attempt to construct at a European level a system of regulation which has proved difficult to maintain nationally, and to complement the internal market, with its competitive tendencies, with a set of policies to maintain social standards. It must be said, however, that these provisions are still rather weak and that the EU has not been able to put in place anything like a system of fiscal federalism which could compensate losing regions entirely for the effects of market adjustment or for asymmetrical shocks. Canada and the United States, on the other hand, have no effective system for regulating interterritorial competition for investment, or the subsidy wars, which deplete the public coffers to the advantage of big businesses without increasing the overall level of economic activity.

Rights

A third set of issues concerns equality of civil rights in asymmetrical and complex systems. The nation-state has traditionally been the body which defines and limits civil rights and liberties, and most federal constitutions contain a list of human rights which are enforceable by the courts against both national and subnational government, ensuring a certain uniformity of citizenship. It was the Supreme Court in the United States which opened the way for civil rights in the 1950s and 1960s, when the federal political system was unable to deliver. As the nation-state has weakened, there has been a tendency in recent years to the development of international civil rights codes, though the mechanisms for enforcement are weak. In Europe, civil rights are increasingly Europeanized through the European Court of Human Rights, which comes under the Council of Europe. It is widely accepted that a common set of justiciable rights is an important counterbalance to territorial decentralization, in order to sustain common citizenship and to protect minorities within the federated units. Yet there are two problems which arise from this. It may give an excessive amount of political power to the courts to resolve what are essentially political problems and it may lead to efforts to constitutionalize policy demands, which are also properly the province of ordinary politics. The role of the courts has expanded considerably in European countries, but Europe has not witnessed the judicial activism of the United States. Nor has it seen the tendency, as in recent Canadian constitutional negotiations, to try to constitutionalize policy demands or to substitute general principles of equality with lists of categorical rights applicable to specific elements of the population.

Democracy

A fourth issue concerns the "democratic deficit." Federalism and regional devolution have been promoted partly as a means of bringing government closer to the people and allowing more diversity in policy choices. Yet, by subjecting regions more tightly to the disciplines of the global market, this may effectively limit the policy options available to government. At the same time, the increased complexity of government and the unequal distribution of skills needed to operate in this environment make citizen participation and democratic control more difficult. Intergovernmental policy making may facilitate problem solving, but the resultant policy belongs to no government in particular, making it easy for politicians to blame the intergovernmental negotiation for the outcome and escape responsibility for their decisions. It tends to "executive federalism" in which legislatures and public opinion count for less, and governments and bureaucracies for more.

Much has been made recently of the principle of subsidiarity as a way of coping with the conflicting pressures of competition among governments versus social solidarity, and with the conflict between the division of powers and the need for cooperation. Subsidiarity is a complex and controversial principle, and extremely difficult to define or operationalize, but essentially it is a way of reconciling unity and diversity. It stipulates that decisions should be taken at the lowest level possible, with a preference for civil society over the state and for local and regional government over national government. At the same time it is rooted in a conception of society as an organic whole, with duties of reciprocity and social solidarity. It is thus not a recipe for neoliberalism, nor for the heedless decentralization of tasks down to levels of government which lack the capacity and resources to discharge them. Understood in this way, subsidiarity, a principle derived from pre-modern society, is a way of addressing the dilemmas of contemporary society covered in this paper. Yet subsidiarity is not essentially a legal or constitutional principle, amenable to judicial interpretation; it is far too subtle and complex for that. Rather, it is a social principle, a guide to action, which is either rooted in culture and social practice or it is not. German cooperative federalism, with its complex combination of decentralization and unity, bound by principles of solidarity given expression in the revenue-sharing system, exemplifies a form of subsidiarity, but this is under pressure even in Germany, and it is difficult simply to export it into other cultures.

Implications

Functional trends are leading to a reconstitution of territorial politics and government, with simultaneous moves to globalization and supranational integration on one hand, and decentralization on the other. Flexible governing arrangements are needed to accommodate this (Courchene, 1995a), but

constitutional forms tend to lag behind functional realities. Governing institutions can never be determined entirely by functional requirements, since they reflect identity and loyalty, and must serve the needs of democratic deliberation and decision. Yet if they get too far out of line, new problems of accountability and democracy arise. So constitutional arrangements do matter and need to be addressed.

The second implication of this discussion is that the relationship between politics and territory is restructuring in different ways in different places. There is therefore no one model of government to fit all situations. Constitutional asymmetry is a necessary concomitant to the asymmetry of the political and social reality facing us. We need, therefore, to ask what are the problems with asymmetrical arrangements, who is substantively damaged by them, and what are the essential elements that must be kept uniform.¹⁴

The third implication is that the threat to solidarity posed by competitive federalism, or the race to the bottom, threatens both social equity and economic efficiency. If these are undermined, then national unity is also placed in question. Judicial mechanisms for ensuring equal rights are likely to become more important as the role of government weakens. Issues of social equity also need to be central to federal discussions, and the role of the national welfare state is vital here. Common values and norms are needed to sustain this solidarity since, if merely reduced to a common market, Canada would have little reason to exist. These do not, however, need to imply a singular and unitary national identity. On the contrary, modern societies can sustain multiple identities, as long as there are certain common values. In the case of Canada, these are to be found in a model of society rather than ethnic exclusiveness or chauvinism. Institutions are also important, to provide incentives to interprovincial cooperation and avoid the more destructive tendencies towards protectionism and neomercantilism. In this, as the Europeans have discovered, a central authority with some real power is essential.

Notes

- 1 This was inspired by the example of the German Weimar Republic, a weak-form federalism.
- 2 This is essentially the case in the minority nations of Scotland and Catalonia and is the aspiration of Québécois civic nationalists (Keating, 1996a).
- 3 Switzerland does operate a policy of territorial unilingualism, but the units are not always the federated cantons. In some cases, individual communes or valleys have their own regime (Steinberg, 1996; Kriesi, 1995). The cantons had their origins in medieval leagues of communes

- in an age before language was the primary badge of social identity. Later, Switzerland was racked by religious wars, in which the lines of conflict cross-cut linguistic cleavages.
- 4 At a time of overall full employment, diversionary regional policies could be presented as in the interests of development regions, which gained jobs, of booming regions, which benefited from the relief of development pressures, and of the national economy, which gained production from otherwise underutilized labour in the development areas.
 - 5 Sometimes this is expressed as a distinction between "power over" and "power to."
 - 6 For example, Washington was able to force states to adopt a minimum drinking age of 21 by threatening to withhold highway funding.
 - 7 Cooperation mechanisms include the Conference of Heads of Government, interparliamentary and party bodies, the Committee of Mediation (between the Bundestag and Bundesrat), the missions of the Länder in the capital, and the Financial Planning Commission. In addition there are horizontal conferences of Land minister-presidents and ministers (Leonardy, 1996).
 - 8 This is not surprising, since until 1995 the regional and community governments were formed from members of the national parliament. They are now elected separately, but since there are no national parties, there is no one to speak for the Belgian federal interest.
 - 9 As well as by seriously misinterpreting European regional experience and committing a host of factual errors.
 - 10 Rhodes (1996) counts six principal meanings.
 - 11 I have spent many hours trying to explain just how Scotland is governed and why it has its own bank notes but not its own currency; its own law but hitherto no legislature; its own international soccer team but no seat at the United Nations.
 - 12 Public choice approaches to the organization of government, which assume that government can be broken up into multiple individual transactions, often ignore this question of deliberative democracy.
 - 13 This is the difficulty in making decisions in systems with multiple actors and veto points. It is the obverse of the virtues of cooperative federalism.
 - 14 I discuss this problem at length in Keating (1997a).

COMMENTS ON
MICHAEL KEATING'S PAPER
RONALD L. WATTS

Michael Keating's paper sets out very well a general and comparative context for the subsequent discussion at the conference upon the prospects for

decentralization in Canada. Since such discussions in Canada are so often based mainly on a consideration of the Canadian, United States, and Australian literature, this paper provides a useful counterbalance by focusing especially on European experience, both in European federations and the European Union. This is illustrated by the proportion of references cited in the endnotes: over four-fifths of the literature cited consists of works published in Europe, including Britain.

Let me say at the outset that I find myself in hearty agreement with Michael Keating's three conclusions following from his analysis, although this will come as no surprise to those who have read my own work. For emphasis I repeat those three conclusions. First, under the simultaneous contemporary pressures for globalization and supranational integration on the one hand and decentralization on the other, the functional trends are leading to a reconstitution of territorial politics and government and of federal political systems. Second, because of varied conditions, no single model of government or of federalism fits all situations, and because of the asymmetry of political and social reality constitutional asymmetry may be necessary in some circumstances. Third, while the recognition of multiple identities and decentralization are essential aspects of any effective federal system, by themselves these are insufficient. Equally important are common values and commitments (although not necessarily a common nationalism) to sustain solidarity and an overarching loyalty within a federal system. Federalism essentially involves both decentralist and integrative elements.

Michael Keating's paper raises many interesting questions to which it is difficult to do justice in a brief commentary. My comments will be divided into two major sections: major points which I endorse and commend for consideration, and areas where I have some caveats.

POINTS COMMENDED FOR CONSIDERATION

There are four major points in Michael Keating's paper which I would largely endorse and commend for consideration.

First, particularly useful is the distinction between two traditions of federalism: the Anglo-American tradition derived from the United States model, and the European tradition which has quite distinct roots. On the comparison of these two traditions I would draw attention to a recent book edited by Michael Burgess and Alain Gagnon (1993) and to the writing of Thomas Fleiner (1993) in Switzerland, both of which have emphasized this distinction. Sometimes, the labels of jurisdictional federalism and organic federalism have been used to distinguish the two traditions. Michael Keating quite rightly points to the convergence of these traditions, although he dates the overlaps, interdependence and coordination in the non-European federations as a more recent development than Elazar (1962) or Stevenson (1993), who found elements of these in the early years of the

United States and Canada as federations. From the beginning, particularly in both the United States and Australia, the interpenetration and interdependence of governments is a feature that was encouraged by the constitutional creation of extensive areas of concurrent jurisdiction. Canada, which is almost *sui generis* among federations in emphasizing in its constitution the exclusive jurisdiction of each level of government, has in spite of this found intergovernmental interdependence unavoidable.

Second, in its discussion of federal principles, Michael Keating's paper draws attention to the particularly interesting concept of "territorial political exchange"; that is, the notion of loyalty to the regime in exchange for policy concessions in relation to fiscal and economic matters and cultural and political autonomy. This concept is significant because it makes the distribution of powers within a federal system more than a zero-sum game. This has been especially significant in the European Union, where the roles of the tiers have been defined in terms of policy goals rather than the allocation of competences. This approach in the EU has in practice been a major factor in the Commission's accumulation of power. Although the principle of subsidiarity was intended to put a brake on this, I agree completely with Michael Keating's point about the difficulties in practice of defining and operationalizing the principle of subsidiarity. The issue in the end comes down to who decides on the application of the principle; that is, *who* decides what powers are necessary to achieve the stated objectives of the European Union.

Third, on the significance of territory in contemporary politics, Michael Keating argues, correctly in my view, that the territorial principle for the organization of government is not only surviving rather than being attenuated, but is also being transformed into new forms in the face of the pressures of the global economy.

This is an important point for discussion, which might include consideration of four points. One is the issues identified by David Elkins (1995) relating to the variety of possible non-territorial forms of political organization. Another is the Belgian experiment in combining territorial and non-territorial forms of federalism in a federation composed of both territorial "regions" and non-territorial "communities" as constituent units. There are some signs that the territorial aspect is tending to predominate, but Belgium as a recently emerged federation has had too brief a federal existence to allow firm conclusions to be drawn from this experience yet.

A third point to consider among new developments is the recent evolution of multi-tiered federal systems. While early in the paper Michael Keating adopts a restrictive definition of federalism, defining it in terms of two tiers, a noteworthy contemporary trend is that increasingly federal arrangements have involved more than two – that is, multiple – tiers. For example, the European Union contains three full-fledged federations (Germany, Belgium, and Austria) and one emergent federation (Spain). The

result of these multiple tiers is increased complexity. Another aspect of the trend to multi-tiered federal relationships has been entrenchment within some federal and quasi-federal constitutions, such as those of Germany, India, and South Africa, of local governments and their powers. The importance of local governments has also been reinforced by the political impact of the growing significance in the global economy of "international cities" within federations. As far back as 1959, Pennock drew attention to the potential efficacy of multi-tiered federal arrangements. The increasing prevalence of such multi-tiered arrangements has implications for the significance of territory in contemporary politics. A fourth point is the increasing erosion of the boundary between domestic and foreign policy, leading to the activity of subnational governments and even of major cities internationally, a subject on which both Ivo Duchacek (1988) and John Kincaid (1992) have contributed useful analyses.

Fourth, Michael Keating's discussion of asymmetry within federal systems is particularly relevant since so much of the Canadian constitutional debate during the past thirty years has been between those favouring increased asymmetry and those resisting this or even advocating reduced asymmetry. This is clearly illustrated in its latest form in the apparent contradictions embedded in the Calgary Declaration with its recognition of Quebec's uniqueness combined with repeated pronouncements about the equality of the provinces. Michael Keating's paper provides a wealth of illustrations of asymmetry in the European experience. To these can be added the significant earlier examples of India and Malaysia. Tarlton first drew attention in 1965 to the elements of asymmetry in the political dynamics of most federations. More recently the issue of asymmetry in federal systems was considered extensively in the sessions of the International Political Science Association Research Committee on Comparative Federalism and Federation at the IPSA Congress in Berlin in 1994.¹ In the analysis of the notion of asymmetry within federal systems we need to minimize confusion by distinguishing between political and constitutional asymmetry, between asymmetry of jurisdiction and of influence in federal decision-making, between transitional and permanent asymmetry, and between asymmetry among full-fledged constituent units and asymmetry in relation to peripheral units (such as territories, federacies, and associated states).

SOME CAVEATS

To the above points of endorsement, I would add five caveats for consideration. *First*, Michael Keating in this paper consciously adopts an approach to the definition of federalism that in my view is too restrictive. I have found more useful Daniel Elazar's (1994) distinction between the broad genus of federal systems, combining elements of "shared-rule" and regional "self-rule," and the variety of species within this genus represented by constitu-

tionally decentralized unions, federations, confederations, federacies, associated states, and joint functional authorities.² Furthermore, within each of these species there is considerable variation, including differences in degrees of decentralization. Among these species of federal systems an important distinction is that between federations and confederations. The intergovernmental character of the federative institutions in confederations (the European Union in its current form is predominantly a confederation in character) has consequent impacts upon their vulnerability to complaints of democratic deficits, and upon their capacity to sustain substantial programs for the redistribution of fiscal resources by comparison with federations where the federative institutions have their own direct electoral and fiscal base. In considering the various species within the broad genus of federal systems, the notion of a spectrum of species also has some utility, for the various species tend at the margins to shade into each other just as the identifiable colours in a spectrum shade into bordering colours. Thus, unitary systems, federations, confederations, and so on, while distinct forms, tend at the margins to shade into each other.

Second, the concept of decentralization needs closer analysis. Michael Keating at one point suggests that the distinction between federations and unitary systems has become less relevant in terms of decentralization because of complex patterns of interdependency in federations and functional decentralization in unitary systems. While broadly true, the subject of decentralization is more complex than that. Since decentralization is a central topic of this conference, the conceptual issues in assessing and measuring decentralization and relative autonomy need close analysis. There are at least four problems in assessing degrees of decentralization in a political system. These are: (1) how to define what the concept of decentralization refers to, (2) how to measure it, (3) how to relate different indices of measurement to each other, and (4) how to compare measurements across countries and over time.³ Two significant aspects of decentralization need to be distinguished: (1) the scope of jurisdiction exercised by each level, and (2) the degree of autonomy or freedom from control in exercising that jurisdiction. The latter issue has led Elazar (1987: 34-8) and Osaghae (1990) to distinguish contractual non-centralization as a definitive characteristic of federations as distinct from top-down decentralization within unitary systems. In assessing the degree of decentralization or non-centralization, various dimensions need to be considered: legislative decentralization, administrative decentralization, financial decentralization, decentralization to non-governmental agencies, constitutional limitations, the degree to which political parties and interest groups are decentralized, and the character of federal decision-making processes. There are difficulties in how each of these is to be quantified, in the weights to be put on each of these different indices, in the measurement of the degrees of interdependence or influence of governments on each other, and in some cases in measuring the degree of asym-

metry in the jurisdiction of constituent units. All of these elements are relevant, however, to the assessment of the degree of decentralization and constitutional non-centralization within a political system.

Third, the categorization of "strong" and "weak" federalism raises two concerns. First, we need better labels because these particular ones are open to misinterpretation. Strength or weakness applied to federalism depends on whether federal systems are being viewed from the point of view of devolution or of aggregation. Michael Keating, taking a devolutionary perspective in this paper, describes as "strong federalism" situations where decentralization and autonomy predominate and as "weak federalism" those that are centralized. On the other hand from an aggregatory point of view, as adopted by many other commentators, "strong federalism" usually refers to those federations marked by strong and effective federal governments and "weak federalism" as those with weak federal governments. Stewart (1984) in his dictionary of federal concepts has documented some 600 different ways in which authors have used labels to play what he calls "invent-your-own-federalism" to distinguish different forms, thereby contributing to conceptual confusion. Among such labels are culinary definitions such as "layer-cake federalism," "marble-cake federalism," "birthday-cake federalism," and "upside-down-cake federalism." In the choice of labels to distinguish kinds of federalism it is important to avoid terms that lend themselves to ambiguity.

A second concern about this categorization in Michael Keating's paper relates to the placing of some of the examples cited. The classification of Austria as "strong federalism" (as defined by him) is surprising. In fiscal terms Austria is much more centralized than Australia or India, which he classifies as examples of weak federalism, and the Austrian form of Bundesrat gives the Austrian Länder far less influence in central decision-making than is the case in the German Bundesrat. Among the examples of "emerging federalism" cited there is an enormous contrast between the quasi-unitary form of the new South Africa and the hybrid of predominantly confederal features combined with some elements typical of federations found in the European Union, yet they are classified together.

Fourth, Michael Keating's paper makes an important point that where there are ethnic majorities within constituent units there are always minorities on the wrong side of the line. Indeed, I would note in passing that this is one of the reasons why so many federations have constitutionally entrenched rights enforced by the courts – to protect such regional minorities from their regional majorities. But when Michael Keating refers to Belgium as the only state basing its federal divisions on linguistic criteria, this simply ignores the evidence. For example, it takes no account of the total reorganization of state boundaries in India in 1956 (with some further subsequent adjustments to complete the process) on primarily linguistic lines aimed at making most of the states unilingual. Nor do I find his analy-

sis of the Swiss cantons convincing. Not all Swiss cantons are unilingual (as his footnote 3 points out); nevertheless, of the eighteen German-speaking cantons and half-cantons, in seventeen the German-speaking majority represents substantially over 90 percent of the population (Graubunden being the sole exception). Of the six French-speaking cantons, the French-speaking majority in four is comparable to Quebec, being over 77 percent, and in the other two it is over 65 percent. In Ticino the Italian majority constitutes 89 percent. One should note as well the issues which led to the carving out of the new canton of Jura and the procedure of cascading referendums followed in establishing its boundaries.

Fifth, is the issue of the efficacy of federal systems. Michael Keating is right to draw attention to the increasing complexity of federal systems and to the resulting problems of achieving cooperation and coordination. In support of this, he cites the oft-quoted criticism by Scharpf regarding the "joint decision trap" as a feature of German integrated federalism and EC policy-making. But at the same time we also need to give consideration to Martin Landau's (1973) insightful contention that redundancy within federal systems has in fact been a major factor generally contributing to system reliability in federal systems.

CONCLUSION

Despite the caveats that I have noted, I think Michael Keating's paper sets out very well the broad context for the more specific discussions slated to follow in the subsequent sessions of the conference.

Notes

- 1 These papers are in process of publication under the editorship of R. Agranoff, and should appear in late 1999.
- 2 See also Watts (1996: 6-14).
- 3 For a more extensive analysis see Watts (1996: 65-74).

Efficiency, Reliability, or Innovation? Managing Overlap and Interdependence in Canada's Federal System of Governance

EVERT A. LINDQUIST

INTRODUCTION ¹

If we were to discover the Canadian federal system standing trial in the court of public opinion, it would likely be responding to two indictments. The first would centre on the interminable sabre-rattling of political leaders that heightens emotions and generates enormous uncertainty but seems to have solved few problems for groups and citizens. The second indictment would focus on the problem of overlap and duplication in federal and provincial programs during a time when, in recent memory, Canadians have experienced growing deficits, high unemployment and taxes, and concerted efforts to downsize and restructure government activities at all levels. I think it is fair to say that a large majority of citizens would anticipate a quick trial and guilty verdicts.

My purpose in this paper is to illuminate discussion on the second charge, that of the problem of overlap and duplication in our federal system. The charge of overlap is easily made and believed, but the persistence of the problem should give us pause. I begin by briefly reviewing the Canadian literature on overlap and duplication. I suggest that the literature has reached a plateau, and it has failed to account for the continuing existence of overlap in the federation. On introducing alternative images of overlap, I suggest that perhaps the problem is not overlap *per se*, but how we conceive of it. We live in social and economic systems characterized by patterns of interdependence and complexity, and therefore overlap is intrinsic to governance problems. I show how the overlap "challenge" can be seen as much broader than many believe, and identify different strategies for comprehending and managing overlap.

The second and longest part of the paper consists of four case studies of recent federal and provincial experience in managing overlap. I describe how the federal and provincial governments – usually through the lens of

Ontario interests – have dealt with the recent initiatives to encourage harmonization of environmental protection and regulations, to improve support for research and development at universities, to initiate health-care pilot projects, and to rationalize food-inspection systems. I then compare and contrast the factors and strategies that have contributed to successes and problems in managing overlap and complexity. I conclude by suggesting that the state of knowledge of Canadians about how they are governed, as well as the impoverished images they hold about their own capacity for change, allow for exaggerated political gamesmanship, which can be counterproductive with respect to furthering change and conveying to citizens how governments actually work. I suggest some modest informational and rhetorical strategies that governments could employ to remedy this state of affairs.

FEDERALISM AND COMPLEXITY: IS THE PROBLEM OVERLAP OR ITS MANAGEMENT?

One does not have to search far in Canadian newspapers to realize that “overlap” or duplication” is perceived to be a big problem of governance. Political and administrative leaders alike condemn it and regularly promise to eliminate the problem, often insinuating that significant savings can be realized. The existence of overlap in federal and provincial jurisdictions, and in the delivery of programs to citizens and groups, has long been held out as a strong argument by premiers for why the federal government should delegate or cede powers to their governments (Gordon, 1994).

The interest in reducing overlap accelerated after the constitutional reform process came to a screeching halt in 1992 following the referendum, supplanted by a sustained attack on deficit and debt reduction by federal and provincial governments. The federal Liberal government launched an Improving the Efficiency of the Federation initiative in December 1993, one specifically designed to minimize overlap in services, and signed several bilateral agreements with most provinces and territories except for Alberta, Quebec, and the Northwest Territories.² Its 1994 Program Review was designed to ask tough questions about whether the federal government should retain involvement in many program areas or devolve responsibilities to the provinces or to other service providers, but the final decisions focused on significant expenditure reduction measures in federal programs, largely due to the increasingly sensitive and rapidly evolving Quebec situation. Following significant cuts in transfer payments to the provinces, the federal government announced unilateral interventions into areas of provincial jurisdiction, notwithstanding its pledge in the 1996 Throne Speech not to do so unless preceded by consultation with the provinces. And so the problem of overlap remains a significant problem in the eyes of provincial and territorial governments.

But is overlap really a problem? There are several notable studies that have, in different ways, defined the debate. Perhaps the most controversial study was written by Germain Julien and Marcel Proulx, which focused on

the extent of overlap and duplication between federal and Quebec programs that had some degree of overlap (Julien and Proulx, 1978). The Treasury Board of Canada released the findings of a comprehensive study in 1991, which reviewed all federal programs and attempted to classify the extent to which those programs overlapped with provincial programs with respect to the clients served and the service provided (Canada, 1991). The study found few instances of duplication in its review, though the detailed studies on which the document was based were never released. In 1992, another study was published by the Alberta government, which examined overlap with federal programs based on discussions with its officials (Alberta, 1992). Taken together, the studies indicated that there was *some* overlap in anywhere from 50 to 65 percent of the federal and provincial programs, but they did not document many, if any, instances of outright duplication (Brown, 1994). A calculation that has received widespread attention emanated from a 1990 study by Pierre Fortin, which assumed that \$5 billion or 2 percent of the non-debt expenditures by the federal and provincial governments are wasted (Brown, 1994). These studies and others, however, were subjected to a withering, concise, and yet thorough review by Gordon Brown (Brown, 1994). He argued that the studies do not provide meaningful empirical evidence on the nature of overlap, and suggested that they either assert the need for increased provincial responsibilities or for the perpetuation of existing arguments in defence of federalism.

Like Gordon Brown, I find the debate on overlap in the Canadian context sterile and misleading. The empirical debate will remain stalled until a thorough, detailed, and independent research effort is launched. However, such a study would be very expensive to do properly and would be unlikely to be supported because, no matter how credible the analysis, the findings would become political footballs and easily misinterpreted in the public domain. But my concern is deeper. These studies and the larger debate are rooted in very traditional approaches to governance, which give primacy to jurisdiction, as opposed to citizen needs and preferences, and do not deal with the implications of trends such as globalization and the information revolution. Arguably, neither the provincial autonomy nor the federal argument serves citizens well, nor do they adequately convey the ways governments have actually worked or the ways in which they are now working. This suggests that we need alternative conceptualizations of overlap in federal systems, and different types of empirical evidence. To this end, I have undertaken four case studies in order to illuminate how overlap has been managed between federal and provincial governments in recent years. Before delving into those case studies, however, it is necessary to develop new ways to interpret the problem of overlap.

*Reconceiving Overlap and Duplication:
Efficiency, Reliability, Innovation*

In common discourse, but even in ostensibly sophisticated treatments of

administration and governance, the presence of overlap and duplication is regularly viewed in negative terms and cast as dysfunctional. From the earliest days of the public administration literature, the goal of reformers has been to achieve the most "efficient" administrative arrangements and to specify the "right" assignment of responsibilities, in the name of clarity, lower costs, and better government. This perspective has resurfaced more recently in the form of the managerialist and the new public management movements, which emphasize not only the need to lower costs and to secure efficiencies but also to better serve clients, by "one-stop shopping" and "single window" services. Such views are also consistent with early views on federalism, with well-defined or watertight jurisdiction or domains of responsibility. In this view, overlap is essentially an "evil" in a federal context because, according to the studies by the Julien and Proulx and the Treasury Board of Canada, its presence can lead to conflicting objectives and confused accountabilities, divide the overall resource effort of governments so that full economies of scale cannot be achieved, and increase coordination costs across governments.

There are, however, other equally powerful, more positive images of overlap in systems. Here, the seminal contributions are those of Martin Landau, who pointed out that in mechanical and organic systems, redundancy – overlap and duplication – increased the ability of those systems to either avoid or respond to error (Landau, 1969, 1973). Landau railed at the narrow concerns of early and contemporary administrative reformers and theorists who sought efficiency and clarity in roles of the components of systems; he argued they ignored the value that groups and citizens place on reliability and error minimization. Allan Lerner later showed that the benefits of overlap need not come only from duplication, or varying degrees of "enlightened waste," but could also obtain from alternative approaches, including "stressing the survivor" and "mobilizing the reserves" (Lerner, 1986). These concepts encompass different meanings and empirical content in different policy contexts, but they generally force us to take an "outside-looking-in" view on governance systems rather than an administrative one. Citizens and groups appreciate overlap when one level of government either withdraws support or cannot lend support due to political or resource considerations. Indeed, they may provide a more useful point of departure for analysis in federal systems when either government cannot give up constitutional and statutory authorities because of either legal obligations or public opinion.

Landau pointed to another more positive function of overlap, which derives from the notion that different units in a system, with their own values and ambitions, may seek new opportunities and to innovate in order to further their own interests. Rather than emphasizing reliability, this view highlights the creative potential of competition among units that can be involved in delivering a program. Systems would be thus viewed as experimental and engaged in a process of learning. Such interpretations are consistent with models of competitive federalism, which suggest that political leaders have great incentive to win over voters by responding to their needs,

and that public service leaders have incentives to demonstrate the competencies of their departments. Indeed, the more complex the problems or tasks at hand, the more likely this dynamic will be at work, and multiple perspectives should increase the likelihood that creative solutions can be found. Let me suggest that this interpretation should resonate with those public-service leaders who call for horizontal management across department and ministry "stovepipes."

Evaluating overlap through the lenses of reliability and innovation suggests that there is limited purchase in examining overlap only in efficiency terms; the latter may lead to simplistic and even counterproductive conclusions. Understanding that overlap may further the goals of reliability or innovation may provide some explanation as to why governments have found it difficult to eliminate the overlap "problem."

On the other hand, introducing these alternative images does little to redress the worry of policy-makers, groups, and citizens. Overlap does have non-trivial costs, and there are limits to the aggregate costs that can be countenanced. Moreover, there are limits to the benefits of increasing reliability and innovation by means of overlap. For example, an emphasis on ensuring reliability by means of parallel or overlapping authorities might serve to stifle innovation or lead to confusion about accountabilities. In short, we need a broader view, one that recognizes that trade-offs must be made among the values of efficiency, reliability, and innovation when evaluating current programs and designing new programs in a policy domain – and that aggregate costs, clarity in accountability, and political competition matter too – but that different balances will be struck in each policy domain at different times.

Perhaps the "overlap problem" is best stood on its head. Rather than invariably denigrating overlap and trying to make it disappear, perhaps we should acknowledge that, like well-functioning markets, overlap and the complexity in which it flourishes is a *condition*. Regardless of the administrative and federal arrangements negotiated at points in time, overlap will invariably be discovered or emerge in unanticipated areas, reflecting the intrinsic complexity and interdependencies of federal, administrative, and economic systems. We know, too, that citizens and groups will not cease making political demands and that the shared interests and jurisdictions of different levels of governments will persist. In this view, overlap is a feature of all complex systems that must be better managed and, as I argue later, properly conveyed to citizens if they are to gain a good sense of proportion about governance and how the public sector functions in a complex world.

*Reconceiving Overlap and Duplication:
Domain, Evolution, Management Strategies*

Overlap can lead to inefficiency, but it may foster reliability and innovation in complex systems. If overlap and complexity are conditions that need to be acknowledged and then managed, rather than vilified or suppressed, can we find more interesting ways to frame and analyse them?

Perhaps it is best to begin by recognizing that overlap and complexity are not only features of federal-provincial relations in Canada, they are features inherent in political, market, and administrative systems. Thomas Courchene notes that nation-states, due to a rapidly changing political and economic environment, are not only losing sovereignty; but that it is "leaking up" to international organizations and agreements, "leaking down" to other orders of government and communities, and "leaking out" to the private sector (Courchene, 1995a).

There is a parallel here, though slightly more elaborate, for governance and overlap. There is, of course, from a provincial standpoint, overlap "upwards" in terms of federal jurisdiction and programs, but there is also overlap "downwards" with regional and local governments. In addition, there is overlap "inwards" with respect to shared and complementary programs and competencies within and across provincial ministries and portfolios. Finally, there is overlap "outwards" with institutions in the private and the non-profit sectors that deliver or could deliver services on behalf of provincial governments. Such overlap has long existed, but is receiving higher profile due to the search for opportunities to deliver government services in different ways; indeed, one precept of the new public management is to operate, where possible, parallel systems in order to reap the benefits of competition.

This broader view is consistent with, though not as sophisticated as, the model that Albert Breton has developed over the years. He characterizes the dynamic described above as "competitive government," by this he means not only that governments compete with higher or lower orders of government, but also with other governments and the private sector in order to provide services demanded by citizens (Breton, 1996). In short, even if the wildest dreams of province builders were to come true and the federal government were to fully withdraw from several policy fields, there would remain considerable overlap – downwards, inwards, and outwards – to manage. Even if a provincial government absorbed prior federal effort in that domain, overlap would persist as a management and a policy challenge because it would emerge along different modalities.

So overlap is a pervasive feature of governance systems. However, expanding the scope of a problem is not usually the best strategy for gaining some closure or insight. Is there another way to conceive of overlap and complexity, one that promises to assist in better comprehending how they are, and ought to be, managed?

I would like to propose that understanding how overlap is managed is analysed best within a policy domain by means of a life-cycle approach. Rather than attempt assessments at the system level, closer insight should emerge from examining how governments enter, compete, cooperate, and vacate particular policy domains, which may vary considerably in terms of scope, resources, challenges, and clients. It is useful to think of three stages of competition and overlap over time:

- *Developing new niches.* Governments are driven, whether through political opportunism or public demands, to identify and respond to emerging problems and demands in a policy field. If the challenges are new, it expands the possibilities for innovation by agencies across and within governments, and increases the likelihood of competition inside and outside the public sector, particularly if there are strong public demands for action. Uncertainty about the willingness of other governments to act increases the incentive to enter the field. Governments also enter fields, even if others have already done so, in order to defend interests and to compete better in the future.
- *Institutionalizing arrangements.* As the parameters of a social problem become better defined and there is increased understanding of the effectiveness of different institutions and interventions, this paves the way for mutual adjustment and clarification of roles within and across governments. This process is driven in part by scarce resources, and in part because most of the political benefits of occupying the field have been reaped. Accordingly, agencies inside and across governments have incentive to mutually adjust their activities or to cooperate.
- *Monitoring and adjustment.* Arrangements will remain more or less intact unless internal or external events and developments alter the character of the policy field and redefine the interests of governments. External events may include dramatic shifts in government expenditure plans that significantly loosen or tighten purse-strings, opportunities presented by new technologies that create new challenges or offer new solutions, and finally, newly defined government priorities. Internal events may include shifts in the preferences of existing clients or the emergence of a new client base, as well as incidents or performance indicators that show existing approaches do not achieve expected results. Such events may lead governments to vacate the field (particularly if few political gains remain), develop new approaches, or seek alternative intergovernmental arrangements.

This framework is meant to guide empirical inquiry, not to stand as a deterministic model of change in all circumstances. The particularities of, say, "developing new niches," should vary considerably across the range of policy fields and should depend on jurisdiction, competencies, scale, and resources. Such an approach should help to delimit and locate some of the challenges that are inevitably inherent in managing overlap and complexity.

Is it possible, then, to characterize how overlap is managed by governments and their agencies? It is a well-known proposition in organization theory that the operational objectives, tasks, and technologies of organizations determine the interdependencies and the competition they need to manage (Thompson, 1967). If overlap derives, in part, from the intrinsic nature of the tasks at hand and from the problems that need to be addressed, as well as the nature of the interest of other governmental agencies, there ought to be

different patterns of overlap in each policy field. However, there is bound to be a limited menu of strategies for governments attempting to manage and coordinate in the face of such complexity. I have already invoked the term "mutual adjustment," but this strategy might be utilized in very different circumstances: in the wake of unilateral action – which embraces entering, vacating, or a radically shifting involvement in a field – by one government (*ex post* mutual adjustment); successful anticipation of unilateral actions (*ex ante* mutual adjustment); or cooperation (planned mutual adjustment). Each of these strategies, whether anticipatory or reactive, may characterize the actions of all actors in a field or a few dominant ones, thus defining norms for managing overlap and intergovernmental engagement. However, new norms or rules of engagement can emerge, as well as formal institutions – which may include working committees or agencies – to channel discussions, conflict, and planning. With respect to the latter, it is important to determine if formal institutions exist to exchange information or also to make decisions, and whether this proceeds on a bilateral or multilateral basis.

My final comments are reserved for incorporating citizens and consumers of government programs into the analysis of managing overlap. To the extent that general public opinion is negatively disposed to political leaders and their officials, and to the extent that citizens and groups believe that waste in government is a problem, they will adopt a "taxpayer" perspective and demand that overlap be eliminated, very much in the efficiency tradition. I have already noted that the demands of citizens, either as voters or consumers of services, and of interest groups will influence the readiness of governments to enter, vacate, or modify involvement in certain policy fields. This rendering of citizen and group involvement is consistent with either the reliability or innovation perspectives, but it is important to realize that the taxpayer perspective sets constraints on resources available for use in particular policy fields. Thus, just as there is a tension in determining the balance that must be struck between efficiency, reliability, and innovation in assessing what is an appropriate amount of overlap, so too is there a tension between the views of citizens and groups on these matters. Their shifting attitudes and interpretations of the performance of governments, individually and collectively, will affect the urgency with which governments address problems and the political capital they can bring to bear.

Polling indicates that citizens and groups do not care which level of government delivers services, but it matters that a service is delivered well. This finding has been used to support the argument that only one government should provide a service, or to justify the movement toward single-window service delivery, on the presumption that citizens do not need to know how the service was financed and coordinated; they just want it delivered. The risk here, of course, is that overlap will effectively be hidden: if citizens and groups do not comprehend how the service was actually delivered, they will be less able to evaluate how well governments perform in terms of efficiency and coordination. Presumably, the reliability issue will be better addressed if the arguments of the new public management advocates carry

the day; they believe that governments should be evaluated and held to account with performance indicators. However, though held out as a form of transparency, it is not clear whether citizens and groups can meaningfully interpret such indicators and results (Lindquist, 1998) and in the context of intergovernmental activities, discern how the competing interests and administrative arrangements behind programs are managed, so as to form good judgments on how well their interests have been served.

FOUR CASE STUDIES

An important objective of this paper is to develop some empirical insight on how overlap and duplication has been managed between federal and provincial governments since the early 1990s, and to assess whether or not it remains an important issue on which to focus. Due to the enormity of the topic as well as time constraints, a systematic investigation of these issues could not be attempted, and instead several recent cases of collaborative federal-provincial-territorial policy-making and some recent federal interventions in areas of shared jurisdiction were selected. The first two cases – which review the creation of the Health Transition Fund and the Canada Foundation for Innovation – provide examples of federal and provincial policy-making in areas of shared jurisdiction as a result of the exercise of the federal spending power. The second two cases review the events leading to the Canada-wide Accord on Environmental Harmonization and the Canadian Food Inspection Agency, and provide examples of federal and provincial negotiations over regulatory responsibilities in areas of concurrent jurisdiction that attract great public interest. These cases were chosen because they dealt with issues currently high on the policy agenda and because they involve very different policies.

The cases should be viewed as exploratory as opposed to definitive treatments of each policy domain: their purpose is to identify issues and opportunities for further debate and study. Each case will be reviewed on its own terms – with particular attention paid to how the issue emerged, the nature of political and bureaucratic engagement, the extent of consultation between the two levels of government, the flexibility of the program designed by the federal government, and the transparency and public understanding of the programs and policy domains in question – and then similarities and differences will be identified.

Health Transition Fund

It is hard to imagine a more contentious policy field than the management of Canada's health system. Not only do Canadians value high-quality health services, but they also demand that all citizens have similar access to those services. In the postwar era, the provinces and the federal government managed to build, primarily by means of cost-sharing programs, a medicare system that has long been the envy of the world, but one for which constitu-

tional responsibility rests primarily with the provinces. The system was designed around hospitals and physicians, and was elaborated during an era when economic growth was sustained and government finances were less precarious. Several pressures – a more diverse, aging, and geographically dispersed population, increased competition in the provision of professional services, and demands to reduce governments' deficits and outlays – are forcing federal and provincial governments to restructure how they finance and deliver health services.

It is in this context, and amidst the myriad of health-related federal and provincial programs which emerged over the years, that the Health Transition Fund (HTF) was announced in the February 1997 federal budget. It is a three-year, \$150 million program intended to support pilot projects that will inform the transition in medicare. The HTF is to be managed in partnership with provincial and territorial governments through the Federal/Provincial/Territorial Conference of Ministers of Health. The federal government has proposed that it be "used to finance specific projects in the areas of pharmacare, homecare, primary care, including clinical preventive health care, and evidence-based decision-making."³ However, in order to understand how this program came to be designed, the reaction of provinces such as Ontario, and its relevance to the broader restructuring of health-care services in Canada, we must first consider the recent initiatives of the federal government with respect to the National Forum on Health and the Canada Health and Social Transfer, and the activities of the Conference of the Provincial/Territorial Ministers of Health.

A year after the Liberal government came to power, the prime minister fulfilled a Red Book promise by announcing the creation of a National Forum on Health, which he would chair along with the minister of health, and which would consist of twenty-four members from across Canada. Its purpose was "to involve and inform Canadians and to advise the federal government on innovative ways to improve our health systems and the health of Canada's people" (National Forum on Health, 1997). The timing of this initiative was interesting because, in the autumn of 1994, the Chrétien government was in final stages of its Program Review. Federal ministers had uneasily agreed that bringing the deficit under control in a concerted manner would be the highest government priority, and were making crucial decisions about the resource reductions and program restructuring in particular policy sectors for the next three fiscal years (Greenspon and Wilson-Smith, 1996; Armit and Bourgault, 1995; Paquet and Shepherd, 1996). One important decision was announced in the February 1995 budget: to consolidate and to dramatically reduce transfers to the provinces under the Canada Assistance Plan and Established Programs Financing, the latter targeted for post-secondary education and health. Many provinces had already started the process of reforming their health-care delivery systems in response to the combination of increasing costs and federal funding that had levelled off under the Mulroney government. When he announced the National Forum on Health, the prime minister had to have known that the restructuring of

health delivery systems was about to accelerate dramatically, and the federal government would reduce support to the provinces.

The Canada Health and Social Transfer (CHST) announcement dramatically reduced federal support for shared-cost programs. Federal cash transfers to the provinces were predicted to decline from \$17.5 billion in the 1994-95 fiscal year to \$9.6 billion in the 1998-99 fiscal year (after the Quebec abatements), a reduction of \$7.9 billion (Canada, Department of Finance, 1997: Table 3.7; Boessenkool, 1996). And while the federal government granted the provinces greater latitude to move funds across health, post-secondary education, and social assistance programs, it did insist that the provinces adhere to the terms of the Canada Health Act with respect to health programs. This meant the provinces and territories had to guarantee that their health plans provided universal and comprehensive coverage, operated on a non-profit basis, provided for third-party billing, and ensured that benefits were portable across provinces (Cohn, 1996). They were greatly angered by the federal announcement, one that effectively "offloaded" many of the tough expenditure decisions onto lower orders of government and yet sought to inculcate in the public the expectation that health service standards could be maintained when the federal share was declining significantly to a 20 percent share of funding. It created public concerns that the federal government might withdraw entirely from health, and emboldened the Alberta and British Columbia governments to test federal resolve about enforcing provisions of the Canada Health Act pertaining to extra-billing (Cohn, 1996). Following the annual premiers' conference that summer, provincial and territorial governments initiated a process in September 1995 to develop a vision of a national health-care system, one that would challenge the work of the federal government's National Forum on Health.⁴

The deliberations of the Conference of the Provincial/Territorial Ministers of Health culminated in the release of a report, *A Renewed Vision for Canada's Health System*, on January 29, 1997. The report, informed by the deliberations of several working groups,⁵ had been requested by the annual premiers' conference in August 1996 in order to serve as a submission to the Council on Social Policy Renewal meeting of federal, provincial, and territorial ministers. Interestingly, the working groups agreed to focus on "roles and responsibilities" rather than on the issue of overlap and duplication, believing that it would be more useful to identify unmet needs. One feature of the report is its succinct description of how the entire health-care system works, before explaining how provincial and territorial ministers might alter the regime:

What is commonly understood as the national health system consists of three distinct elements: the diagnosis and treatment of acute illness; continuing care for chronic disease and disabilities; and health promotion, protection and disease prevention. All of these elements are primarily delivered by provinces/territories. The Canada Health Act applies only to the funding of insured hospital and medically necessary physician services. Other key elements of provincial/territorial

health systems which include such services as home care, long term care, rehabilitation, and pharmaceutical programs, are provided by provincial/territorial governments but do not fall under the provisions of the Canada Health Act.

The federal role has been primarily confined to health services for Aboriginal people, for the Canadian forces, for veterans, and for the RCMP. The federal government also supports health research, licenses drugs and medical devices, and has substantive role in health protection and promotion. In 1948, the federal government began providing grants in support of provincial health services such as public health, mental health, tuberculosis, and upgrading of physical facilities. In the 1960s, the federal government began to provide some funding to the provinces/territories for insured hospital and physician services (Conference of the Provincial/Territorial Ministers of Health, 1997).

The report, of course, notes the decline in federal "cash" funding from 50 to 20 percent, but goes on to express the fact that the provinces and territories affirmed the five principles of the Canada Health Act. However, it recommended greater recognition of the need for efficiency and the link between other demands on provincial budgets and federal contributions, improved accountability, more predictability in federal funding, a more collaborative and consultative posture by the federal government, and more responsibility to be exercised by Canadian citizens on health matters. It also called for more "evidence-based" policy decisions and for an independent mechanism that would report to the Conference of Ministers of Health to recommend how to resolve disputes between federal and provincial governments over insured hospital and medical services.

The report was released just days before the February 4th release of the report of the National Forum on Health (National Forum on Health, 1997), and the federal, provincial, and territorial ministers of health met later that month. The report affirmed the importance of public funding for necessary services, a single-payer system, the principles of the Canada Health Act, and called for a strong partnership between federal, provincial, and territorial governments. More interestingly though, the report notes the restructuring in the organization and delivery of primary care across the country, and recommends that home-care be fully integrated into provincial and territorial health systems, that publicly funded services be expanded to include "medically necessary drugs," and that there be greater focus on patient needs rather than on services as primary care is realigned by the provinces and territories. The Forum recommended that these interventions be informed by "evidence-based innovation" and that the federal government create a transition fund (\$50 million per year for three years) to support pilot projects to inform innovation. It also called for strategies to benefit children and families, to strengthen communities by working with foundations, and to develop special approaches for supporting Aboriginal communities. This recent federal interest in funding for children angered the provinces since they had to cut social assistance and other programs due to the CHST reductions, but

the federal government sought to take credit for announcing a new program in the area.

As noted, the federal government did announce the Health Transition Fund in the February 1997 budget. However, this was not an auspicious start insofar as provincial and territorial governments were concerned. There was no prior consultation with the would-be partners, notwithstanding the federal commitment in the 1996 Throne Speech to consult and secure agreements with the provinces and territories before using the spending power to move into areas of shared jurisdiction. Moreover, several priorities identified for pilot projects are clearly in provincial jurisdiction and do not fall under the Canada Health Act, such as pharmacare, home-care, and primary care. Provincial and territorial leaders have several worries: first, that many provinces and territories have programs in these areas and the federal government may be manoeuvring to expand the scope of the Canada Health Act; and, second, that the federal government will unfairly raise public expectations about the need for and feasibility of supplementing these programs when it is not prepared to fund a substantial portion of the costs. This latter concern extends even to the pilot projects themselves. When funding ends, which level of government will take on the responsibility for announcing the end of the pilots? Finally, although the program budget is not inconsequential, when one considers that Ontario will spend close to \$17.8 billion during the 1997–98 fiscal year on health care, and that cuts in federal transfers to Ontario have amounted to \$2.1 billion (though not directed exclusively to the health domain) (Ontario, Ministry of Health, 1997), the \$15 million per year the province stands to receive for pilot projects does seem like a proverbial drop in the health-care bucket.

The program, however, does have several positive features. First, the federal government made it flexible. Approximately, 20 percent of the funds are to be allocated to “national” pilot projects,⁶ while the other 80 percent is to be allocated on the basis of population to the provinces and territories, who will indicate the projects they wish to support. This should mean that a province like Ontario, which already has pharmacare and home-care programs, can identify pilots in primary care which promise to be more relevant to the major restructuring of hospital and community care now in progress. Here, the process will be important: the unilateral announcement of the program means the federal government must restore trust as it develops and implements the program. Second, the provinces and territories will benefit from pooled information emanating from pilots across Canada. But this presumes that only the most relevant, innovative, and useful pilots will be chosen across the participating jurisdictions and that the projects are well designed, properly evaluated, and have the results disseminated. In other words, pilot projects can be chosen in such a way as to minimize overlap and duplication in testing new ideas across provincial jurisdictions. And, if a well-funded pilot might cost approximately \$1 million (many others will cost far less), and if there are multiplier effects in terms of increasing savings or effectiveness across jurisdictions, the program could be very valu-

able indeed, and liberate scarce funds for other health services.

The evolving debate over health care can be described as a shift of where "reliability" and access to high-quality care is to be guaranteed by Canadian governments. Canada's modern health-care system was predicated on a medical and hospital-based model, and emerged out of a cooperative process between federal and provincial governments, even if many provinces were concerned about the use of the federal spending power. The desire to control government expenditures during the late 1980s and early 1990s led the federal government to re-evaluate its commitment to funding health and other programs (in part because it did not get credit for funding those programs) and forced provincial governments to close hospitals and reduce services. The strategy of the federal government was to cut transfer payments and play on the lack of public understanding of how health care was funded; it shifted blame to the provinces for rationalizing institutions and services while appearing to defend the integrity of the system. This was not a cooperative process.

By the late 1990s, most governments have balanced their budgets, but citizens are worried about the quality of health care. Such circumstances create new political opportunities, particularly for the federal government, which sees a new niche and potential to claim credit for innovation; the provincial governments naturally cry foul. Despite the federal rhetoric about cooperation, the process by which the Health Transition Fund was designed does not inspire much confidence on the part of provincial governments. However, the political realities are such that, while health care falls in provincial jurisdiction, it clearly constitutes a national value. The path forward ought to involve cooperation and mutual respect: the federal government should have the right to target its funding for specific programs and to have accountability, but the responsibility of the provinces to tailor such programs for their own needs and to manage them differently must be recognized.

*Canada Foundation for Innovation
and Ontario's Challenge Fund*

The 1997 budgets of the federal government and the Ontario government are noteworthy because they each announced new initiatives to support research at Canadian universities. Responsibility for science, technology and research was not delineated in the *Constitution Act* of 1867, so both levels of government have, over time, developed interests, programs, and institutions in these domains. The modalities of provincial interest are connected to their responsibilities for universities, health programs, tax initiatives, intraprovincial trade, transportation, communication, environment, agriculture, and natural resources. The federal government, through its spending, taxing, and residual powers, has supported granting councils and provided broad block funding of universities through Established Programs Financing, and it funds numerous research enterprises in many departments

(Agriculture and Agri-Food Canada, Defence, Environment, and the National Research Council are just a few examples).

In his February 18th, 1997 budget, the minister of finance announced that the federal government would establish a Canada Foundation for Innovation. Its purpose is to provide financial support for modernizing infrastructure at institutions engaged in research activities – such as universities, colleges, research hospitals, and non-profit research institutes – in the areas of health, environment, science, and engineering.⁷ Federal outlays will be \$180 million over five years (\$800 million in total) but the goal is to use those funds to lever more funding from provincial governments, the private sector, and the voluntary sector, so that as much as \$2 billion can be raised. The federal government has indicated that it would consult before drafting legislation to formally establish the Canada Foundation for Innovation. However, the foundation will be an independent corporation with a board of directors who are to select the projects, with the federal contribution across projects to be no more than 40 percent.⁸

The Canada Foundation for Innovation will join a battery of federal programs and institutions that support a range of research and development activities. They include the federal Network of Centres of Excellence, the National Research Council's Industrial Research Assistance Program, and the research supported by three granting councils: the Natural Sciences and Engineering Research Council, the Medical Research Council, and the Social Sciences and Humanities Research Council. These programs are complemented by research-related programs supported by Technology Partnerships Canada, the Business Development Bank, and the Health Services Research Fund (the latter both announced in the February 1996 budget). And then there are the federal tax incentive programs amounting to \$1 billion for the scientific research and experimental development tax credit and another \$3 billion for labour-sponsored venture capital corporations. The Canadian Foundation for Innovation seems designed in such a way as to minimize overlap with existing federal programs, hence the focus on targeting the support towards upgrading research equipment, computer networks and other capabilities, databases, and laboratories and installations attached to projects likely to persist for some time, as opposed to funding research activity itself.

The announcement of the Canada Foundation for Innovation suggests that the federal government – notwithstanding its considerable outlays on research – recognizes that there is a serious problem with respect to losing, or not properly supporting, talented researchers due to inadequate research facilities. Furthermore, it suggests that the federal government recognizes that many federal and provincial programs designed to sponsor research have explicitly avoided supporting facilities. Interestingly, although the budget and other documents do not explicitly acknowledge this link, the Canada Foundation for Innovation stands as a natural progression from the Infrastructure Program introduced by the federal government in 1994. The latter was a \$6 billion program administered by federal, provincial, and

municipal governments across Canada, one which seemed to focus on the priorities of local governments and supported more often than not traditional "bricks and mortar" projects. The Canada Foundation for Innovation responds to the need for more forward-looking projects that increase Canada's competitiveness by supporting cutting-edge research and taking advantage of advances in information and other technologies.

How does this most recent federal initiative look from a provincial perspective? One concern from smaller provinces will revolve around whether their own governments and private sectors have deep enough pockets to take full advantage of the incentives provided by the Canada Foundation for Innovation. This is less a problem for the larger and more prosperous provinces. All provinces want to make sure that the program contains sufficient flexibility to meet the research priorities of their universities. From Ontario's perspective, the Canada Foundation for Innovation on its own terms is a welcome program in that it begins meeting a long-standing concern: over the years federal funding has shifted towards research activities and not physical infrastructure or "hard" support, thus leaving it to the provinces to work with universities and private sector funders to rebuild existing facilities or to build new ones.

Interestingly, Ontario – whose researchers constitute the largest block of recipients of "federal" research dollars in the country – was not involved in working-level discussions with the federal government on the Canada Foundation for Innovation proposal before it was announced. Nor was the Council of Science and Technology Ministers (CSTM) used to this end, but this missed opportunity reflects underlying and unresolved federal-provincial tensions, particularly between the federal government and Ontario, that had developed over the years with respect to identifying the total amount of resources that should be allocated to research and development, and the respective roles of federal and provincial governments.¹⁰ Despite these tensions, Ontario has always received a generous portion of federal funding on research and development, reflecting its size, the location of federal establishments in Ontario, and the structure of the Ontario economy, which relies heavily on technology and research. More recent initiatives to ensure that the allocation of funds is better balanced across regions with respect to population have worked against Ontario's interest.

For its part, Ontario developed its own array of programs to support research. The Ontario Centres of Excellence were started in 1987 to better link university research with industry, and the Technology Fund (\$1 billion over ten years) was started in 1988. One can easily identify potential overlap between provincial and federal programs not only in space, telecommunications, and materials research, but also in programs designed to secure collaboration between the private sector and researchers (although the federal focus has tended to be on diffusion of technologies, which includes adoption and commercialization, while provinces have focused more on research and development). The Industry Research Program was started to support collaborative projects between industry, universities, research insti-

tutes, Crown corporations, and government ministries. Finally, Ortech International was created in order to assist with government funding and in managing research and development projects for industry on a cost-recovery basis.

These programs were supplemented and then restructured under successive governments during the 1990s. Under the Rae government the Technology Adjustment Research Program was introduced to find ways to assist workers with adjusting to new technologies. The portfolio of programs was consolidated into the Ministry of Economic Development and Trade as a branch called Technology Ontario (Ontario, 1996). Under the Harris government, these programs were dramatically "re-profiled," reflecting deficit and expenditure reduction priorities. A new Ministry of Energy, Science, and Technology was established. Several programs – such as the Industry Research Program, the Technical Personnel Program, the Technology Renewal Program, the Technology Adjustment Research Program, and the University Research Incentive Fund¹¹ – were eliminated. Others were significantly restructured: funding for the International Research and Development Agreements was reduced by at least 40 percent; as well, the Ontario Centres of Excellence program was renewed for five years, but the seven centres were reorganized into four broad areas in January 1998 with less funding;¹² and Ortech International was touted as a prime candidate for privatization.

With this background, it is easier to comprehend the design and timing of Ontario's R&D Challenge Fund, announced in the May 1997 Ontario budget. The federal Canada Foundation for Innovation put pressure on the Ontario government to act since other governments were more advanced in taking advantage of research and development initiatives, and it could be linked to a commitment to economic development and growth. The R&D Challenge Fund is a \$500 million commitment spread over ten years that is to be levered into \$3 billion by means of business and government partnerships. The Challenge Fund initiative is complemented by various tax incentives for research and development in the private sector and for private sector-university partnerships (such as the Ontario Business-Research Institute Tax Credit). These tax measures are expected to lever an additional \$3 billion over ten years (Ontario, Ministry of Finance, 1997). Ontario's emphasis is to retain and attract good researchers, and to develop the critical mass needed to support cutting edge research, which stands in contrast to the federal emphasis on infrastructure. Although a board for the Challenge Fund will be established, it will not operate at arm's length from the government and will exist for ten years in order to provide more certainty for the research community.

Aside from the focus on retaining and attracting the best researchers, flexibility is also a guiding principle: the Challenge Fund can fund projects that receive support from the Canada Foundation for Innovation, from granting councils at federal and international levels, and from universities and research centres. Although its mandate is broader, it is fair to say that the

Challenge Fund is a chip that Ontario has put on the table in order to deal with the federal government's Canada Foundation for Innovation and to mobilize Ontario constituencies to play in that game. The most immediate challenge for the government is to communicate the existence of these programs to industry leaders, universities, and even other ministries. The goal is to create a constituency and to generate good ideas for projects so as to fully lever the Challenge Fund *and* to fully access federal funding. Even here there is a coordination challenge within the Ontario government: responsibility for contacting the relevant constituencies will proceed under the aegis of the Ministry of Economic Development and Trade (with industry) and the Ministry of Education (with universities).

Despite the unilateral announcement of the Canada Foundation for Innovation, it seems that provincial governments generally welcomed the initiative, largely because it promises to deal with a long-standing gap in the support for university researchers. The provinces, of course, provide financing for research infrastructure and research itself, which presumably reflects the distinctive competencies of those universities as well as the unique economic and social challenges and traditions in each jurisdiction. On the other hand, it is understood that support for research and development should be provided at the national level by means of the federal spending power to launch projects of large scale and to have good peer review processes that come with a larger competitive pool. In other words, it would not make sense for either the provinces or the federal government to withdraw from funding research; indeed, many observers would argue that the most pressing problem is not overlap, but rather, a combination of insufficient global funding for research and critical gaps in support. We can see that the multiplicity and flexibility of programs delivered by governments, each designed to deal with different niches, is dedicated to furthering innovation.

Both the Canada Foundation for Innovation and Ontario's Challenge Fund are well-focused yet flexible programs; their design reflects the identification of gaps in a relatively institutionalized, if underfunded, policy domain. Although the programs did not emerge from cooperative processes of policy development, they are designed to maximize the impact of another government's outlays. However, unlike the case of the Health Transition Fund, their success is not entirely dependent on cooperation across governments. What remains to be seen is whether meaningful support will be forthcoming from the private and non-profit sectors. And, unlike colleagues in the health sector, policy-makers interested in furthering the cause of research and development cannot count on public opinion to keep their issues at or near the top of the policy agenda. This suggests that with respect to better managing overlap, federal and provincial governments will not have the incentive to better coordinate and monitor programs at the national level and, in this regard, to rely more heavily on the Council of Science and Technology Ministers as the fulcrum for such activities.

*Environmental Protection and Assessment:
Harmonization Initiatives*¹⁴

Until the 1960s, environmental policy was a low-profile issue in the larger realm of intergovernmental affairs, a domain handled largely by provincial and local governments. According to one account, the "provinces consequently played the dominant role in environmental protection, with the federal role generally limited to more direct constitutional responsibilities such as coastal and inland fisheries. As a result, the roles played by the two orders of government did not often overlap or conflict" (Canadian Council of Ministers of the Environment, 1996). This state of affairs had not changed by the early 1970s even though environmental issues had received greater public attention and the federal government had established a Department of Environment. As Kathryn Harrison has observed:

The mutually agreeable division of labour between federal and provincial governments that evolved during this period involved the federal government conducting research on environmental problems and control technologies, and setting a limited number of national standards in consultation with the provinces. It was the provinces that took the lead role in environmental protection: setting their own standards, monitoring source performance, and taking responsibility for enforcement of both their own and federal regulations. Harmonious intergovernmental relations prevailed largely because the federal government deferred to provincial authority and declined to test the limits of its own jurisdiction. (Harrison, 1994)

Mark Winfield has also noted that harmony prevailed because the federal government was unwilling to risk provincial ire in the larger game of constitutional politics and because it was willing to achieve its objectives in certain areas with bilateral agreements with provincial governments that delegated enforcement responsibilities (Winfield, 1997).

This era of cooperation changed dramatically during the late 1980s and the early 1990s as the federal government and the provinces responded to growing concerns of environmental groups and the public about the state of the environment. Several federal initiatives – such as the adoption of the Canadian Environmental Protection Act (CEPA) in 1988, the \$3 billion Green Plan in 1990, and the Canadian Environmental Assessment Act (CEAA) in 1992 – upset the "harmonious" division of labour between the federal and provincial governments. These initiatives were clearly intended to "arm" the federal government with statutory weapons and resources to play in the environmental sandbox with more authority. The federal government developed regulations on hazardous chemicals and pulp and paper effluents, and committed Canada to meet targets contained in international agreements signed at the 1992 United Nations Conference on Environment and Development in Rio de Janeiro.

It was against this backdrop of an increasingly worried public and growing assertiveness on the part of the federal government that a new regime governing federal-provincial relations took shape during the late 1980s and early 1990s. In 1988, a new Canadian Council of Ministers of the Environment (CCME) was established in Winnipeg. CCME is of interest for several reasons. First, it sought to deal with environmental protection and regulation in a forum without natural resource ministers at the table (previously, environmental ministers met as part of the Canadian Council of Resource and Environment Ministers). Second, the work of the national forum was predicated on a consensus approach to implementing environmental policies across Canada. Third, CCME established its own secretariat, whereas other federal, provincial, and territorial councils typically relied on secretariats provided on a rotating basis by their members. The CCME was overhauled in 1990, in reaction to the federal Green Plan and great public pressure to develop national approaches on environmental issues. Several agreements were negotiated by participating governments: the National Contaminated Sites Remediation Program, the National Packaging Protocol, the National Action Plan to Phase out CFCs, the NOx/VOC Management Plan, the Canadian Water Quality Guidelines, the National Action Plan to Encourage Water Use Efficiency, and Canadian participation in the Rio conference (Canadian Council of Ministers of the Environment, 1996; Harrison, 1994). All these activities were lubricated by expanding budgets at the federal and provincial levels.

The backdrop for environmental policy-making soon shifted radically because governments began to focus on deficit reduction and program restructuring. The June 1993 restructuring of the federal government and its public service halted the ascendancy of Environment Canada by removing Parks Canada from its ambit; its budget immediately declined by 40 percent, dramatically accelerating the cuts announced in two previous budgets. The short-lived Campbell government also indicated that it would seek a more cooperative approach with the provinces on environmental issues, responding to business and provincial frustrations with court challenges on major projects but also anticipating funding reductions. A newly elected Liberal government, which did not return Parks Canada to Environment Canada, soon expressed its interest in pursuing non-constitutional approaches to restructuring the federation with its "Improving the Efficiency of the Federation" initiative, which embraced environmental matters. Following its 1994 Program Review exercise, the Liberal government reduced Environment Canada's budget by a further 32 percent (Toner, 1996). Provincial governments also began to reduce outlays for environmental programs as part of deficit reduction initiatives, a trend that was accelerated by the sharp reduction in federal transfer payments announced in the February 1995 federal budget.

It was in this context that CCME began working to harmonize federal, provincial and territorial programs in environmental assessment, regulations, and standards. The goal was to develop a more predictable and less

costly review process for a business community dealing with two levels of government, to discourage downward competition between the provinces (Winfield, 1997), and to ensure "greater consistency to environmental laws and policies across the country" (Canadian Council of Ministers of the Environment, 1996b). It was a very complicated process: in June 1993, there were 100 agreements for 80 different activities (Canadian Council of Ministers of the Environment, 1996). The workplan included more clearly defining the role and responsibilities of each level of government, identifying minimum standards, and developing a "single window" for participants in environmental protection and impact assessments. This was to be accomplished by means of a multilateral and national process in eleven different functional areas; the final product would be an Environmental Management Framework Agreement (EMFA). In effect, CCME would produce a national policy regime. Despite the considerable substantive and political complexities, significant process was made in drafting agreements. By late spring 1995, a draft agreement was prepared for consideration by CCME at a meeting in Haines Junction in the Yukon Territory.

The meeting, however, sounded the death knell of the harmonization process as originally conceived. The federal minister of environment, Sheila Copps, informed by the views of national environmental groups, balked at the agreements negotiated by her own officials, believing that EMFA would restrict the ability of the federal government to intervene in environmental matters. This greatly angered provincial representatives and other participants, and certainly reduced any trust that had developed. The process could have stalled indefinitely, but in September 1995, the annual premiers' conference called for the initiative to be put back on track. This plea was soon reinforced by the prime minister, who understood that, along with labour market training programs, environmental management issues were seen as the leading irritants within the federation; hence, federal strategists believed that making progress in both areas could demonstrate the viability of "non-constitutional approaches to reform of the federation" (Winfield, 1997). In addition, responsibility for taking the lead on CCME matters had shifted to Ontario, and the province supported revitalizing the harmonization process. Minister Copps agreed to allow the draft EMFA document to be circulated for public consultation in October.

The consultations reflected the major fault-lines in the environment policy community.¹⁵ Environmental groups argued that the federal government was giving up its clout over the provinces, that the EMFA did not attempt to address gaps in standards, monitoring, and assessment, and that it might lead to an insufficiently transparent regime, a *de facto* new level of government. Business groups continued to argue that overlap and duplication were "serious and costly problems." They sought a more efficient, simple, consistent, and predictable regulatory regime. Aboriginal groups, like the other groups, complained about their exclusion from the drafting process and worried about how harmonization would relate to land claim negotiations, self-government agreements, and new northern territories. Municipal governments

sought more involvement, though they supported harmonization. Finally, most provinces – even those with the greatest enforcement capacity – were in the midst of restructuring their programs due to resource reductions, and had incentives to work with the federal government to achieve the most with available resources.

With these views in hand, the CCME announced a new process at its May 31, 1996, meeting, subsequently endorsed by the June 1996 First Ministers' Conference. There were to be two crucial differences in this round. First, rather than have a comprehensive EMFA agreement, the goal has been to have a tighter focus and negotiate agreements on environmental assessment, enforcement, and standards. Second, the stated goal would be to *improve* environmental quality and the effectiveness of programs across the country, rather than have as a primary objective the removing of overlap and duplication between levels of government. Business and provincial governments might settle for more stringent standards and enforcement in exchange for increased certainty about the regulatory regime and greater efficiency in the filing and information gathering processes, such as single-window arrangements with the larger provinces that have standards and regulatory bodies of their own. None of this involves either jurisdiction relinquishing statutory authorities.

By late November 1996, an agreement-in-principle was secured for a Canada-Wide Accord on Environmental Harmonization, but substantive details had not yet been worked out in sub-agreements on standards, inspection, and environmental assessment. Drafts were circulated in early spring 1997. The nub of agreement on environmental assessment was to ensure that provinces would be the lead and function as a single window, even though federal and provincial governments would not relinquish their respective statutory authorities. With respect to standards and inspection, the crucial details revolved around agreeing on the scientific basis and process for establishing different standards and on a schedule for implementation. The CCME meeting at which the agreements could have been ratified was scheduled for May 1997 but was cancelled because of the federal election. On January 29, 1998, the CCME finally ratified the Canada-Wide Accord on Environmental Harmonization, which called for the retention of existing authorities, improved coordination in assessment, inspection, and standards, and improved public reporting on results by all governments. Further negotiations were to proceed on additional sub-agreements on enforcement, monitoring and reporting, research, environmental emergencies, and processes for the participation of various stakeholders. Interestingly, Quebec refused to sign the agreement, arguing that the federal Parliament should amend legislation and "recognize the need to reduce overlap and duplication between the jurisdictions."¹⁶

Kathryn Harrison, writing before the EMFA meltdown precipitated by Sheila Copps, asked, "Is harmonization desirable?" (Harrison, 1994). She noted that possible benefits include better utilization of scarce government resources, more competitive firms since costs might be reduced with similar

standards in place, and improved accountability in a complex policy domain. On the other hand, the risks include less "backup" enforcement by another government if one fails to meet its obligations or promises, and less support for smaller provinces without sufficient capacity. Moreover, she noted that since the CCME operated on the basis of consensus, there would be a tendency to adopt less stringent national standards. Mark Winfield has argued that CCME functioned best when it was a forum for discussion and exchange of information among officials, which produced guidelines and technical standards in selected areas (Winfield, 1997). When CCME evolved into more of a "national" decision-making body it was exposed to non-environmental considerations, such as the provincial interest in economic development and the federal desire to move forward with non-constitutional reform of the federation. The result, Winfield argued, was diminished trust between environmental groups and the CCME, and reduced accountability for performance on environmental issues. Both Winfield and Harrison agree that federal intrusion led the provinces to improve their effort in environmental management, although strong public support and a growing economy were contributing factors.

In short, environmental activism and growing public concern about the quality of the environment during the late 1980s led to increased government involvement, particularly at the federal level, and to a proliferation of new legislation and programs. These programs emphasized the value of reliability or reducing environmental risks. CCME originally was created in order to deal with technical issues across jurisdictions, but soon emerged as a forum for addressing the concerns of business about the costs and uncertainties generated by regulatory and legal processes. These concerns, and later the enormous pressures on budgets due to deficit reduction, led policy-makers to see overlap increasingly in efficiency terms. CCME became an experiment in cooperative planning and policy-making, limited ultimately by its scope and by nervousness on the part of federal leaders about ceding too much power. While efficiency goals remained predominant, CCME eventually produced an agreement that nodded more in the direction of improving the quality of the environment. Whether the right balance was struck, particularly in the wake of significant expenditure reductions on environmental programs by all governments, will await receipt of further evidence and the judgement of citizens and communities.

Canadian Food Inspection Agency

The quality and safety of food products is something that Canadian citizens take for granted. Both the federal government and provincial governments are involved with food inspection by means of authorities for interprovincial and intraprovincial commerce, respectively. In addition, the federal government exercises criminal law powers over unsafe and unhealthy products, whereas provinces regulate local matters, which, where on-the-ground inspection and enforcement is concerned, is often delegated to local govern-

ments. In April 1997, the Canadian Food Inspection Agency was established by the federal government as part of an overhaul of the national regulatory and inspection regime. Although the implementation of the new system is still unfolding, this case is noteworthy because the initiative came in response to budget reductions and international pressure to develop consistent standards and inspection systems.¹⁷ It is also noteworthy because the federal restructuring was informed by a process that engaged provincial governments, municipal governments, and industry groups.

Interest in rationalizing the food inspection function emerged because of industry concerns about how domestic regulations and inspections were handled, particularly with respect to the new rules of the World Trade Organization and the North American Free Trade Agreement. In addition, pressures for change derived from changing patterns in food consumption by consumers and the ubiquitous demand to reduce administrative costs in all program areas. Moreover, the "inspection and regulation" functions in agriculture (embracing animal health, plant health, food safety and inspection, and management and administration) had been identified as programs of "high concern" in the December 1991 federal study on overlap and duplication, even though it concluded that there was little overlap in the services provided to clients (Canada, Treasury Board of Canada Secretariat, 1991).¹⁸ The concerns derived from regulating what had become a more complicated industry trying to operate in a more complex environment, where it was becoming increasingly clear that "errors" – and one has only to think about how the mad-cow disease episode unfolded in the United Kingdom – could rapidly compromise an entire industry.

The reform process had its origins in the deliberations of the Federal/Provincial Agri-Food Inspection Committee. Participants were probably aware that the Auditor General of Canada was undertaking an audit of federal food inspection programs (Auditor General of Canada, 1994). In 1993, the committee presented its recommendations about developing a national approach to food inspection to the July 1993 meeting of federal and provincial ministers of agriculture. The ministers endorsed the document and asked the committee to develop a policy for consideration when the ministers met a year later. Since inspection was closely related to the responsibilities of health departments and ministries across the country, the ministers of agriculture requested that their federal and provincial ministers of Health participate in the process. This was accomplished by tapping into another standing intergovernmental committee: the Federal/Provincial/Territorial Food Safety Committee. The work of these two committees was coordinated by a joint steering committee, which also invited representation from Fisheries and Oceans Canada and from the Association of Supervisors of Public Health Inspection in Ontario. Notwithstanding the complexity of these arrangements, they reflected an early, shared view about the need to design a good system that could contend with the challenges and that would include federal, provincial, territorial, and municipal authorities.

The result was a draft report developed by the joint steering committee,

Blueprint for the Canadian Federal Food Inspection System, that outlined a "vision" of new system, several principles to guide reform, and an action plan (Joint Steering Committee, 1994). The report was adopted at a July 1994 meeting of the federal, provincial and territorial ministers of agriculture. The agreed goals were to develop a national system that ensured safe and high-quality food; harmonized standards across jurisdictions, which included better labelling practices and developing a common legislative base; better access to international markets by means of recognized standards; effective, risk-based and lower cost inspection, which, for example, would include having common laboratory standards and accreditation; and greater protection from fraud (Joint Steering Committee, 1994). The ministers also acknowledged that although governments had responsibility for designing and operating a new system – one that would have to be well coordinated – industry would have an integral role in its administration. To guide this effort, they called for the creation of a committee, the CFIS Implementation Group, that would have at least twenty members and be co-chaired by two representatives of provincial agriculture and health ministries and one from the federal government.

This recommendation fed into the 1994 Program Review initiated by the federal Liberal government (Armit and Bourgault, 1995; Paquet and Shepherd, 1996), which included programs delivered by Agriculture and Agri-Food Canada and other departments. These deliberations were also informed by the 1994 Report of the Auditor General of Canada on the food inspection programs administered by Agriculture and Agri-Food Canada. The result was a concerted effort to first rationalize programs inside the federal government across the departments of Agriculture and Agri-Food, Health, Fisheries and Oceans, and Industry. The February 1995 Budget was used to announce several decisions flowing from the Program Review decisions, and one was a commitment to improve the food inspection system. An Office of Food Inspections Systems was established in May 1995 with the mandate of developing and reviewing options for integrating the relevant elements of Health Canada, Agriculture and Agri-Food Canada, and the Department of Fisheries and Oceans. In doing so, it was to consult with provincial governments, industry, and groups. The goal was to rationalize programs comprising 5,000 public servants and worth about \$400 million per year (Canada, Department of Agriculture and Agri-Food Canada, 1996).

At the June 1996 First Ministers' Conference, the first ministers agreed to support the initiative and instructed the CFIS Implementation Group to develop recommendations. In addition to working with federal officials to design a new federal agency structure, the group also had to develop plans and principles for renegotiating myriad MOUs already in place with the provinces to deliver services or to agree to utilize the standards developed by the other level of government (that is, federal inspectors enforce provincial standards, or vice-versa, or there are jointly developed programs).¹⁹ These initiatives were set out in a sixteen-part "Structure for Action" which embraced dairy products, meat and poultry, a common legislative base, risk assessment and

management, food retail and food services, sanitary and phytosanitary measures, transportation practices, laboratory coordination, best practices, egg, honey, maple, and horticultural standards, technical barriers to trade, harmonized inspection, and communication.

These developments were welcomed by the Ontario government and many other provinces. The Ontario government had launched the Food Standards Project in the early 1990s to consolidate its own food legislation. Statutory authorities were spread across the Ministry of Natural Resources, the Ministry of Health, and the Ministry of Agriculture and Rural Affairs, so the producers of a single product might have to deal with requirements and inspectors from all three ministries.²⁰ However, the initiative was side-tracked by the restructuring of the Ontario public service, the Expenditure Control Plan, and the Social Contract announcements in 1992-93. Thus, the federal initiative later in 1994 opened a new policy window for Ontario and the other provinces, and a new imperative: if Ottawa better coordinated its programs, it would have a strategic advantage even if a new agency would not materially affect most of the MOUs and arrangements relating to on-the-ground inspections. Ontario secured representation on the CFIS Implementation Group and was the only province to second an official to its secretariat.

The Canadian Food Inspection Agency was formally established as a special operating agency (SOA) in the Agriculture and Agri-Food portfolio in April 1997. However, the new structure did not mean that Health Canada, for example, relinquished responsibility for maintaining standards in this area; it will assess how well CFIA performs with respect to food safety. The SOA form was chosen in order to give the federal government more flexibility to enter into partnership arrangements with the provincial governments and the private sector. It remains an open question, however, as to how provinces will engage in this regard; it seems unlikely that provincial ministers would want to delegate their authorities to a national agency. Governments could effect changes through MOUs or service contracts, or provinces could become more directly involved in the governance structure, which might entail gravitating towards federal-provincial corporations (to which the government but not Parliament can delegate).

Those involved in designing and implementing the new system believe the new agency to be a considerable success, even though full implementation and cost savings will take several years to achieve (Prince, 1998). A CFIS Implementation Group report suggests that high-level political support and industry involvement was essential for moving the initiative forward, but Moore and Skogstad (1998) argue that this "leadership" consisted of allowing officials to treat various food inspection challenges as "technical issues" and not politicizing the process. Second, the Implementation Group report argues that participating governments realized that significant change would take time and require the expenditure of funds early on in the process in order to have a more efficient and effective system in the future. Indeed, a province such as Ontario has yet to consolidate its seven major pieces of

legislation pertaining to food inspection, which cannot occur until the government finds room on its legislative agenda. With respect to expenditures, the hard reality is that federal and provincial agencies have all had to deal with significant resource reductions during the last few years, and provinces such as Ontario are enacting significantly different "alternative service delivery" arrangements for inspecting raw milk and meat inspection. Finally, the report argues that ongoing, systematic consultation and communication about the process and the goals of reform were essential ingredients for the progress made to date (Canadian Food Inspection System Implementation Group, 1997).

The CFIA reform process is noteworthy for several reasons. First, the case shows that overlap does not emerge solely as a result of concurrent federal and provincial authorities, but also from the panoply of relevant authorities exercised by a given order of government, and does not stand as the major challenge confronting governments. As Moore and Skogstad (1998) have argued, "the federalism 'problem' in food inspection then is not a case of eliminating costly duplication. Rather, the task is to coordinate disparate regulatory systems and fill in gaps in the system which arise both from non-mandatory inspection and inconsistency of enforcement within and across jurisdictions." Second, the case suggests that the drive to clarify responsibilities across governments for food inspection and enforcement does not derive solely from demands to secure greater efficiencies and to improve service to citizens, business, and communities. Rather, it is also a response to international pressures for transparency and consistent application of statutory authorities. Finally, this case provides a useful model for cooperation across jurisdictions in a policy domain with many intricacies and interdependencies that can only be hinted at in this brief account. It was noted above that treating food inspection as a series of technical issues allowed for steady progress, however drawn out, to be made by officials negotiating on behalf of their governments. This case also suggests that, even though provincial governments were involved early in the process, the federal government demonstrated leadership by signalling its intent to improve its own operations and providing an opportunity for provincial governments and other actors to be actively involved in the design and implementation of the new agency. This approach developed trust among governments that permitted making progress on cross-jurisdictional issues.

Some Observations on the "Overlap" Cases

In the next section I review some management lessons that emerge from the case studies. Here, though, I want to make some general observations about the four cases. These concern complexity and interdependence, overlap and mutual adjustment, unilateralism, and public engagement.

One cannot help but be struck by the enormous complexity of the issues within and across each policy field, even though this paper has not tried to present comprehensive and detailed accounts of policy developments and

responsibilities in each field. For all the rhetoric about reducing overlap, and without trivializing the efforts to reduce overlap through *ex ante* or *ex post* mutual adjustment, there is much overlap and interdependency that needs to be managed. There may have been a temporary shift in federal spending power and considerable restructuring in programs across levels of government, but the complexity and resulting tensions remain. This points to an important theme of this paper: that complexity is inherent in the policy problems themselves and is not simply a feature of federalism. While governments may alter their resource efforts in certain policy fields, and attempt to rebalance the responsibilities of federal, provincial, regional, and local governments, and of private and non-profit sectors as well, this will not alter the underlying complexity of delivering services to citizens. Indeed, we are presented with a rather troubling paradox: even as governments try to work towards more efficient, less complex, and less redundant delivery systems -- and as they gravitate towards more national approaches -- the processes, committees, and institutions put in place create even more complexity and the perception of more overlap! (Lindquist, 1994, 1996a).

The cases demonstrate that considerable overlap exists across federal and provincial boundaries, but the officials I interviewed suggested there is relatively little duplication across levels of government and argued that, due to deficit reduction plans, there has been considerable incentive to remove unnecessary overlap and duplication. On the other hand, *de facto* overlap persists since governments cannot devolve many statutory responsibilities, nor will citizens permit such actions in other circumstances. This observation echoes the findings of the 1992 Treasury Board Secretariat study. The cases of food inspection and research and development indicate that the pressing challenge for both jurisdictions is less about reducing overlap "upwards or downwards" and more about reducing overlap "inwards," either by creating new institutional forms or by coordinating statutory authorities and existing programs. In other words, it does not make much sense for a government to engage counterparts about rationalizing and focusing programs until it has its own house in order and can indicate its own strategic priorities. Moreover, many provincial officials recognize (or are resigned to the fact) that the federal government has a legitimate presence in each of the policy fields, but the concern of provincial ministers and officials is to ensure that such programs are adapted to local needs and can achieve their full potential, which obviously creates a demand for co-planning and coordination. Many officials would probably agree that mutual adjustment -- even through *ex post* adjustment following unilateral federal initiatives -- has led to the minimization of overlap. Some officials would argue that this result has obtained less because of accommodations worked out in intergovernmental forums, and more because of the activities of front-line staff and partners who cobble together deals and develop creative proposals that take advantage of new opportunities. This should not be construed as saying the provincial officials do not believe that the overlap could not be better managed; they would, no doubt, argue that early collaboration

between governments would help field officials to more easily anticipate, adjust, and innovate with programs.

The federal government acted unilaterally in three of the cases reviewed for this study: in announcing the Canada Foundation for Innovation and the Health Transition Fund, and in withdrawing support for the Environmental Management Framework Agreement process. The provinces were irritated by the first two instances of unilateralism, particularly since the federal government had stated it would not announce initiatives in their jurisdiction without consultation. Although the Canada Foundation for Innovation and the Health Transition Fund programs have the necessary flexibility to ensure that the provinces and territories will collaborate with the federal government and other partners, one wonders what purpose was served by not consulting in advance. Such courtesies are inexpensive and stand as important ingredients in building trust. On the other hand, the reversal of Sheila Copps on the EMFA process, while enormously frustrating to the other governments, reflected responsiveness to the concerns and demands of environmental groups, and a legitimate concern about relinquishing ministerial decision-making powers to a national body. In contrast stands the process that led to the creation of the Canadian Food Inspection Agency: it engaged the provinces and other partners in designing a federal agency, albeit one designed in such a way as to further national and provincial interests. Interestingly, the CFIA Implementation Group, though instrumental in shaping the agency's design, did not have decision-making powers. Recall, too, that Mark Winfield argued that the Canadian Council of Ministers of the Environment was more effective when collaborating on developing standards than when it attempted to construct a national framework and function more as a decision-making body.

To the extent that the cases suggest that overlap has been reduced and/or better managed, it is interesting to consider what forces produced these outcomes. Many officials noted that dramatic reductions in budgets, but also international pressures in the cases of food inspection and research and development, have helped focus attention on how to make the best use of fewer resources. Statutory obligations – and therefore jurisdictional overlap – usually were not relinquished, but incentives were created to coordinate programs within governments and to work collaboratively with other governments. On the other hand, many programs were established, and remain in place, despite significant budget pressures – they were “innovations” introduced by the federal government whether by means of its spending power or concurrent jurisdiction, which came in response to demands for “reliability” from key constituencies. Such innovation will produce competition and tensions across levels of government, but the debate and rivalry produced by this sort of overlap are, to my mind, not problematic at one level – this is the normal “give and take” one would expect in federal systems, particularly on high-stakes issues. What is more problematic is that such struggles are monitored and influenced by a public that often knows very little about the respective authorities of governments, their relative

resource efforts in a given policy domain, and the complexities of the problems and administrative systems at hand. This creates a golden opportunity for counterproductive and even misleading political posturing by governments. However, it is hard to see how such posturing serves the public interest given that there are serious resource constraints, and pressing needs to innovate and experiment, if only to find ways to maintain the reliability of existing programs.

CONCLUDING REMARKS: IMPROVING THE MANAGEMENT OF OVERLAP AND INTERDEPENDENCE

This study, though not a systematic review of overlap in areas of shared jurisdiction, has confirmed by means of four case studies that there does exist considerable overlap in the activities in federal and provincial governments. However, I hope readers are persuaded that, in theory and practice, overlap may not be as dysfunctional as the conventional wisdom suggests, and may contribute in positive ways to meeting the needs of citizens and communities. Although there are limits to the extent to which overlap can be construed as a positive force, I have also argued that it is more appropriate to see overlap as endemic to complex governance systems and the problems with which they cope. Overlap is not simply a feature of a poorly designed federal system; indeed, my case studies indicate that overlap presents more of a problem *within* governments and can be found in any complex system. Overlap, no matter what future scenarios one can imagine for the federation, will remain a pervasive feature of Canadian governance due to constitutional, administrative, and political realities. This reflects the interdependencies inherent in complex economic and governance systems; overlap cannot be readily eliminated, and thus needs to be better understood and managed.

The case studies suggest that government agencies are spending less on programs, and not surprisingly, overlap may be better managed and objectively reduced as a result. In addition, the case studies also provide several lessons about how governments might better handle the overlap they will inevitably encounter, although each policy domain will have its peculiarities and unique challenges. Building trust and demonstrating mutual respect is essential to cultivating cooperative relationships, even in politically charged environments. One way to do this is simply to respect the jurisdiction and interests of the other level of government. However, breakthroughs in managing overlap are far more likely to occur when governments do not *dwell* on jurisdiction; it is far better to identify threats that concern all governments and to evaluate the possibilities for change from the perspective of citizens and communities. The forums chosen to pursue discussions and negotiations should be congruent with the degree of trust that exists, the amount of legitimacy that the forum has in the eyes of affected interests and the public, and the extent to which the policy area is changing rapidly or has institu-

tionalized. Governments should start discussions with counterparts about threats and proposed interventions earlier rather than later, and should resist the temptation to act unilaterally or grandstand when disagreements occur – this will only squander trust for ephemeral, short-term advantage in the media. Where possible, governments should seek flexibility in the final shape that programs can take and find ways to share credit: this is not only a way to respect the jurisdiction and interests of each government, but is also a recipe for increasing effectiveness. Late consultation or unilateral announcements only serve to increase suspicion and the likelihood of further unilateralism and grandstanding in the future. This is a poor way to serve the interests of citizens and communities, and, more generally, it can only diminish the reputation of all governments.

An important conclusion of this paper, though, is that Canadian governments *have* found ways to deal with overlap. More generally, the public sector at all levels has undergone enormous restructuring, and governments are working with other governments, as well as private sector and non-profit sector organizations, in new ways. However, aside from pointing to having met deficit reduction targets, our political and administrative leaders seem incapable or perhaps uninterested in conveying the extent and meaning of that change, and how it is touching the lives of Canadians (Lindquist, 1997). Our leaders have not succeeded in conveying to Canadians the extent to which they have been living in an increasingly experimental system when it comes to governance and administrative practice, and that overlap and complexity will not disappear and may increase, even with “smaller” government. As a result, and despite these developments, governments are still vulnerable to the charge of gross inefficiency due to the existence of overlap, a charge that gets bolstered, rather ironically, when lists are produced of the mechanisms that have been created to manage the interdependencies of the governance system.

The only remedy for this problem is for governments and outside groups to find ways to succinctly and effectively convey the challenges and responsibilities of governments, how they collaborate, and how they connect to citizens (Lindquist, 1996b). One approach is to find more effective ways to depict complexity and interdependence to citizens. A good start is the annex in the Conference of Provincial/Territorial Health Ministers' *Vision* document, which attempts to portray elements of the health system on a single page, although this easily could be elaborated. More generally, the abundance of new communication tools, such as graphics design packages and web sites on the Internet, offer many opportunities for progress in this regard. Second, governments need to use alternative language to address the issues connected to overlap. When critics naïvely call for the elimination of overlap purely on efficiency grounds, responsible leaders should acknowledge that value, and indicate that unnecessary duplication will be removed (while also noting why we have dual brake systems in our cars). Leaders should then invoke the term “interdependence” rather than “overlap,” not only because it better characterizes the world of governance, but also

because it carries less negative connotations. I believe that governments have an incentive to do so because, regardless of their ambitions, they will inevitably find themselves contending with overlap and managing interdependence as their predecessors have done. Better information and the adroit use of language will not bring an end to opportunism by political leaders, for there is considerable gain to be made by criticizing governments in power or other levels of government by pointing to waste or incursions into areas of jurisdiction. Nor will it eliminate the divergent views of citizens and groups on the scope of the public sector and the directions in which their governments should move. But better information and more accurate terminology should serve to give more citizens a better sense of proportion about how our system of governance works and limit the scope for unnecessary and misleading posturing.

Notes

- 1 I would like to express my thanks to Ron Watts for a useful list of references on the federalism literature and to Bill Forward, Craig McFadyen, and Bob Young for their advice on which case studies might inform the issues addressed by this chapter. I would also like to thank those officials who I interviewed and for the documents they sent my way. All errors and misinterpretations are mine alone.
- 2 The bulk of the initiatives dealt with the environmental and food inspection harmonization processes already under way, but others included social housing and business support programs. See Canada, Office of the President of the Queen's Privy Council for Canada, 1994.
- 3 See the update of Health Canada's web site on February 19, 1997 re "Health Transition Fund" at <http://www.hwc.ca/datapcb/communc/home/news/medicare.htm>, and "New Strategic Health Initiatives Important Steps Toward Modern Health System" at http://www.hwc.ca/datapcb/communc/home/news/97_10e.htm.
- 4 This somewhat more focused initiative paralleled a more encompassing set of deliberations proceeding under the auspices of the Ministerial Council on Social Policy Reform and Renewal, which received a report in December 1995 setting out several options. For a summary, see Cohn, 1996.
- 5 Working groups were struck to examine particular issues such as Aboriginal health issues, health protection and promotion, and drug review processes. More attention was devoted to health protection and promotion since it was less contentious and dealt more directly with overlap and duplication, and thus promised more progress. Within this area six key issues were identified: (1) healthy public policy; (2) health intelligence; (3) health information systems; (4) children's services; (5) strategies for community involvement; and (6) environmental assessment and screening. Working group officials discovered there was

already considerable accommodation among program officials working with different governments in the same functional areas, who were more inclined to worry about client needs as opposed to the federal-provincial turf battles. There is also a Deputy Ministers' Working Group associated with the Conference of Federal/Provincial/Territorial Ministers of Health, which in turn has spawned committees on drug safety, pharmaceutical services, health services, population health, and health and human resources.

- 6 For example, part of the \$30 million was to be allocated to host national events in certain provinces concerning initiatives aligned closely to their priorities. For details on the Conference on National Approaches to Pharmacare held on January 18–20, 1998, and on the National Conference on Home Care held on March 8–10, 1998, see <http://www.hc-sc.gc.ca/datapcb/htf-fass/Confer.htm>.
- 7 For more details, see <http://www.fin.gc.ca/budget97/innove/innove.txt>. The issue of how to fund universities for the "indirect" costs of undertaking research has been a long-standing issue for universities. For a detailed account of this and other issues pertaining to universities, see Watts, 1986.
- 8 There is an upper limit of 50 percent federal funding for a given project, which suggests some flexibility across projects and implies that other projects could receive less than 40 percent federal funding.
- 9 The fourteen federal networks of centres of excellence receive a total of \$47 million per year, while the granting councils cost \$750 million each year, but these funds only support research, not facilities.
- 10 The Council of Science and Technology Ministers was established in 1985 as a forum to help develop a national science and technology policy, which the federal government eventually announced in 1987. The policy was to be elaborated with a strategy predicated on several principles: increase support for basic and applied research and development, improve the capabilities of industry to innovate and to take advantage of new technologies, ensure a sufficient number of skilled researchers, and develop a service orientation. A sticking point, though, was the reluctance of the federal government to agree on what ought to be the overall level of resource effort across governments and what roles would be most appropriate for federal and provincial governments in dealing with industry and researchers. In May 1991, a National Science and Technology Action Plan was released by the science ministers, but it was not endorsed by a new Ontario government since it did not deal squarely with resource allocation as budgets were tightening up. The idea of identifying a national research and development target was also supported by provincial first ministers (in 1989), the Forum of Advisory Boards on Science and Technology, the National Advisory Board on Science and Technology, the House of Commons Standing Committee on Industry, Science and Technology (in 1990), and the other research-intensive provinces.

- 11 This program provided matching funds from government for private support of university research.
- 12 See home.istar.ca/~oce. The new centres will focus on information technology, manufacturing and materials, light-based technology, and space and earth sciences. The previous centres were Technology Research Centre, Institute for Space and Terrestrial Science, Manufacturing Research Corporation of Ontario, Ontario Centre for Materials Research, Ontario Laser and Lightwave Research Centre, Telecommunications Research Institute of Ontario, and Waterloo Centre for Groundwater Research. See also Ontario, 1997.
- 13 The Ontario government does have a regional approach to innovation, developed largely through the Ministry of Economic Development and Trade, which is not reflected in the Budget document.
- 14 This section draws on interviews and Toner, 1994, 1996; Doern and Conway, 1994; Harrison 1994; Doern, 1992; and Tingley, 1991.
- 15 For a more detailed summary of these views and more background material, see <http://www.mbnet.mb.ca/ccme/background.html>.
- 16 See Environment Canada, "News Release: Environmental Harmonization Accord approved by twelve jurisdictions," released on January 29, 1998, at http://www.ec.gc.ca/press/harmo_n_e.htm. For different views on the merits of the accord, see the "Commentary" exchange between Michael Cloghesy and Charles Caccia under "Should we 'harmonize' the environmental rules?" *Globe and Mail*, January 29, 1998, and Anne Mitchell and Mark Winfield, "The accord is a tragedy for Canada's environment," *Globe and Mail*, February 2, 1998.
- 17 For considerably more detail and analysis of the design and implementation of the Canadian Food Inspection Agency, see Prince, 1998, and Moore and Skogstad, 1998.
- 18 The study estimated that 1,022 employees then worked in the area of animal health, 697 in plant health, 2,551 in food safety and inspection, and 227 in management and administration. In food safety and inspection the document rated the federal regulatory role as "high" and noted that "services and clients are both partially the same" across jurisdictions.
- 19 See Annex number 3: "Federal/Provincial/Territorial/Municipal Cooperative Mechanisms" in Canadian Food Inspection System Implementation Group (1997).
- 20 The general conclusion was that the system was functioning well. About forty cases of overlap or duplication were identified at the outset, but these were deemed to be minor. There was some overlap at the provincial level in laboratories, particularly with respect to food testing undertaken by the ministries of Health and of Agriculture and Rural Affairs. A memorandum of understanding was negotiated to minimize the overlap by recognizing which ministry had precedence in different situations.

COMMENTS ON
EVERT LINDQUIST'S PAPER
J. PETER MEEKISON

This is a thought-provoking paper which looks at the practice of federalism. The introductory sections give a brief overview of the literature on overlap and duplication. This material is followed by four very different case studies in four distinct policy fields.

Professor Lindquist stresses three key themes which are central to his analysis of overlap and duplication. The first of these is that both the political system and public policy are complex, and this complexity is compounded by the federal system. The second is that interdependence is a key factor in understanding the functioning of Canadian federalism. The third theme is a call for a reassessment of overlap. That word continues to conjure up images of inefficiency and waste. He suggests that a second look warrants consideration. "Rather than invariably denigrating overlap and trying to make it disappear, perhaps we should acknowledge that, like well-functioning markets, overlap and the complexity in which it flourishes is a *condition*." (p. 39). In short, the issue becomes not the elimination of overlap but its effective management, a question which he addresses in the four case studies.

In presenting the four case studies, Professor Lindquist uses what he calls a life-cycle approach where "insight should emerge from examining how governments enter, compete, cooperate and vacate particular policy domains" (p. 40). It is a useful model and analytical tool to help focus one's thoughts on a specific policy area. In developing his analytical framework he observes that "neither the provincial autonomy nor the federal argument serves citizens well, nor do they adequately convey the ways governments have actually worked or the ways in which they are now working. This suggests that we need alternative conceptualizations of overlap in federal systems, and different types of empirical evidence" (p. 37). This comment is preceded by a criticism of existing studies on overlap, "These studies and the larger debate are rooted in very traditional approaches to governance, which give primacy to jurisdiction, as opposed to citizen needs and preferences, and do not deal with the implications of trends such as globalization and the information revolution" (p. 37). I would like to use this comment as the basis for my remarks.

Central to federal-provincial conflicts over overlap and duplication are questions of autonomy and jurisdiction. If this is a traditional approach, then I plead guilty to being an adherent. Disputes about overlap or duplication are inherently differences over the limits of jurisdiction. Such differences take one to the very core of federalism, the division of powers. Governments, both federal and provincial, are very conscious of their jurisdiction and are usually very quick to defend it, as demonstrated by the exten-

sive case law on this subject. Such debates over jurisdiction also conjure up images of watertight compartments. From the perspective of an intergovernmental negotiation, that is a realistic place to start a dialogue.

That said, the reality is, as Professor Lindquist correctly observes, that interdependence is a principal characteristic of public policy today. Interdependence leads to overlap, and to a lesser extent, duplication. As there is a shifting of jurisdictional tectonic plates, there is disruption and occasionally conflict on the federal-provincial Richter scale, after which a new equilibrium is achieved.

Overlap and duplication are facts of life in Canadian federalism. They are reflected in the constitution in several ways. In the assignment of responsibilities, both orders of government were given authority to tax and both exercised jurisdiction over certain aspects of commerce. Whether or not one chooses to characterize this as duplication or an obvious necessity, the fact remains that there has been conflict in both policy fields over the years. The disputes over direct and indirect taxation and inter- and intraprovincial commerce are well known. In addition, two areas of concurrent jurisdiction were established, agriculture and immigration. Concurrent authority is planned overlap. Whether or not it leads to duplication is another matter.

As the Canadian federal system evolved, governments expanded their jurisdictional frontiers, the result being overlap, duplication and, all too often, conflict. It should be noted that technological change contributed greatly to this process. Here one need only think of radio and aeronautics. Conflict resolution has been achieved either through the courts or through the processes of intergovernmental accommodation and adjustment.

The court cases have led to constant refinement or redefinition of jurisdictional boundaries, while intergovernmental processes have led to a complex system of meetings, conferences, and agreements (both bilateral and multilateral), which not only highlight the reality of interdependence but also make it virtually impossible to eliminate. That is the reality of the federal system today. As the paper notes, globalization and the information revolution will only serve to reinforce this trend. "Team Canada" trade missions are the most recent manifestations of this phenomenon.

THE SPENDING POWER

No discussion of overlap and duplication is complete without comment on the federal spending power. More than any other policy instrument, the federal spending power has contributed to overlap and the appearance of duplication. Of the four case studies presented by Lindquist, two – the ones on the Health Transition Fund and the Canada Foundation for Innovation – are a direct result of the spending power.

Thus some attention should be given to this subject area. A recent illustration of the importance and complexity of the spending power is found in the 1992 Charlottetown Accord. The draft legal text for the so-called "six

sisters" (urban and municipal affairs, tourism, recreation, housing, mining, and forestry) is very informative. The section begins with an affirmation of exclusive provincial legislative jurisdiction. This clause is then followed by a series of others, which essentially regulate the exercise of the federal spending power. What is equally instructive in reading these provisions is that two views of the spending power are reflected in the text. Without going into too much detail, the two views represent the perspectives of the have and have-not provinces and the fear on the part of the latter that the underlying motive for the elimination of overlap was, in reality, to provide a way for the federal government to offload some of its responsibilities. These six policy areas were ultimately addressed at the First Ministers' Conference in June 1996. The text on labour market development and training incorporates a similar approach, and recent federal agreements with various provinces in this policy field have resolved this matter.

Another reference to the spending power in the Charlottetown Accord is the section on the development of a framework for the exercise of the federal spending power, which among other things includes a clause saying its exercise should reduce overlap and duplication. (This section should not be confused with the one which limited the exercise of the spending power on new national shared-cost programs. It should be recalled that an identical provision was found in the Meech Lake Accord.) A final reference to the spending power is found in the section on regional development. It is fair to say that the spending power was a prominent theme in the Charlottetown Accord.

Two other observations on the spending power deserve mention. The first is that the spending power manifests itself in different ways. The two case studies that are based on the spending power illustrate some of these differences. The one on the Health Transition Fund depends upon active provincial participation to be effective – a fact noted in the September 1997 Throne Speech. The Canada Foundation for Innovation encourages provincial participation, but the success of the program is not dependent on it, as funding can come from other "partners" such as the private sector and universities. Since all provinces are interested in research and high-tech and the potential economic development benefits, they are usually more than willing to participate in such ventures. The problem the federal government encounters is managing the allocation to ensure that allegations of regional favouritism are not forthcoming.

The second observation is that rather than transferring funds to provincial governments, the federal government can make payments directly to individuals. The millennium scholarship program is a good example of an initiative where the federal government will give funds directly to individuals. The expenditures have obvious implications for postsecondary education and, along with initiatives on research, are a clear indication that the federal government believes it has a continuing role and responsibility in supporting higher education. It fulfills this role through the spending power, either through general grants such as the CHST or specific initiatives where

its profile is much greater. A potential difficulty with the latter is that if the provinces are not involved in the policy development, the seeds of future conflict may have been sown.

REGULATION

Lindquist's other two case studies, environmental harmonization and the Canadian Food Inspection Agency, are equally informative, but their importance arises from an entirely different set of circumstances – the role of the state as regulator. Even here there are differences which require analysis.

Both are areas of concurrent or shared jurisdiction, one of which, agriculture, was formally recognized as such in the Constitution Act, 1867. The other, environmental protection, as a result of various decisions has clearly become an area of shared jurisdiction. There is no single head of power here, and federal and provincial authority stems from a variety of heads of power including the criminal code.

If any policy field demonstrates complexity, it is environment. Indeed, the Beaudoin-Dobbie Committee in 1992 made a clear recommendation about it with respect to constitutional reform – leave things as they are! When one looks at the various policies and attempts to unravel them, one can see why the committee voiced their caution.

Nevertheless, both subject areas are ones in which the public has great interest, and most people are probably not overly concerned about the jurisdictional preoccupations of governments. In short, they are less concerned about jurisdictional squabbles and more concerned about environmental quality and the quality of the food they eat. They want assurance that both are protected or safe. The question in both case studies is how to accommodate and deal with conflicting rules and standards which lead to confusion, overlap, duplication, waste and conflict. How do you deal with these complex policy fields in a systematic and efficient manner?

One possibility is a constitutional amendment. In my view, it is virtually impossible to contemplate a successful constitutional amendment in either area – and, for that matter in most other areas of jurisdiction. Moreover, amendments, if achieved, would probably only add to the confusion and limit flexibility.

What is the alternative to a constitutional amendment? The alternative is harmonization of policies and the negotiation of agreements (bilateral or multilateral) on guidelines, enforcement, and inspection. In short, cooperation. In my opinion, analysis of the current practice of intergovernmental relations and of the future direction is what this conference is about. It is here that one needs to contemplate how to stretch the federation. Instead of a layer cake (or watertight compartments), contemporary reality is what Morton Grodzins described as marble cake. With the image of a marble cake it is easier to grasp the reality of interdependence rather than trying to determine precise jurisdictional boundaries (or lines drawn in the sand), which in the end may prove to be both impractical and unattainable.

To be sure, this does not mean that the development of policy will be conflict-free. The looming debate over greenhouse gas emissions is a case in point. If any policy field underscores Professor Lindquist's globalization argument, it is environmental policy. At the same time, Alberta has voiced its strong concerns about a possible carbon tax and the potential consequences for the oil and gas industry. While the National Energy Program of 1980 has been dismantled for several years, its memory lingers on, and the Alberta government is quick to respond to any possible policy changes which might upset the current policy equilibrium.

If harmonization or streamlining is increasingly becoming a reality in the area of regulation, then analysis and comprehension of the processes by which it is achieved are also necessary. We are told by some commentators that executive federalism is a dead duck, but the two case studies just mentioned certainly lead to the opposite conclusion. The paradox is that the emergence of intergovernmental machinery or mechanisms often creates the impression of overlap and duplication. People ask, Why is it necessary? Isn't this a waste of money? As noted in the paper, more study and better explanations are needed in this area. Here I think the recurring preoccupation of scholars with the constitutional negotiations of the last decade – and the accompanying discrediting of *all* intergovernmental negotiations – has done a disservice because it presupposes, first, that the process of intergovernmental negotiations is inherently flawed and, second, that the only solutions are constitutional in nature.

The purpose of this conference is to stretch the federal system or at least to consider ways in which this reshaping might be a possibility. Assuming that constitutional change is highly unlikely at this time, or for that matter in the foreseeable future, then alternatives to that process need to be both identified and considered. Here is the area where stretching is required. For example, at the last three annual Premiers' Conferences the provinces (without Quebec) have been developing and articulating a new vision of the social union. The vision acknowledges the federal spending power and attempts to create new approaches to joint policy-making in the social union. The premiers' efforts may lead to new structures and processes of federal-provincial decision-making, which include effective dispute resolution mechanisms, transparency, and methods of citizen engagement.

CONCLUDING OBSERVATIONS

The first is on unilateralism. If the management of interdependence is increasingly a fact of life in the federal system, then unilateral action on the part of either order of government may lead to unnecessary conflict and mistrust. Of course all governments will develop new policies and initiatives which affect their neighbours, but they must also demonstrate a willingness to discuss them.

The second is that the continuing debate over national unity and constitutional reform, while of obvious importance, should neither diminish our

willingness nor divert our attention from exploring new ways of managing the federal system. Canadian federalism will continue to evolve. People can debate the cause of the changes and their relative merits, but change is a fact of life and the Canadian federal system has shown itself to be remarkably flexible and adaptable over the years. The reality is that it is capable of being stretched without breaking.

The final message in the paper is that governments must engage the citizenry more in their deliberations. Whether or not this is called accountability or elimination of the democratic deficit, the demand for increased public involvement is perhaps the major distinction between intergovernmental relations of the postwar period and the post-Meech Lake era. Since institutional reform, such as Senate reform, is unlikely, then alternative mechanisms need to be explored and developed. Perhaps that is the greatest challenge – to develop effective mechanisms which integrate executive federalism and public involvement. Yes, this is a conundrum, but progress is essential if the trends indicated by the four case studies continue.

Paying for ACCESS: Province by Province

PAUL BOOTHE
AND
DEREK HERMANUTZ

1. INTRODUCTION

Over the past decade, the fiscal structure of the Canadian federation has changed profoundly. Driven by the need to reduce its deficit, the federal government reduced or restrained the growth of various transfers to provinces below the rate at which provincial programs were growing. The result has been that federal contributions have become progressively less important in financing key provincial programs such as health, education and social services. Further announced reductions in federal transfers will continue this trend for the next several years.

The incidence of these reductions in federal transfers has varied substantially among provinces. Growth in payments under the Canada Assistance Plan (CAP), the transfer financing social services, was restricted for British Columbia, Alberta and Ontario, changing this cost-shared transfer into a new form of equalization. The allocation formula for the Canadian Health and Social Transfer (CHST), which replaced CAP and Established Program Financing (EPF),¹ continued the unequal distribution of these transfers among provinces. As the CHST was reduced by one-third, no reductions were made to the federal equalization program. The unequal distribution of transfers outside equalization has led to serious strains in the federation and undermined support among some provincial governments for redistribution among regions.²

These events have led political leaders and analysts to call for changes in the assignment of spending and taxing powers, and, by implication, in the system of intergovernmental transfers in Canada. Discussion of these issues took place in the negotiations leading up to the Charlottetown Accord of 1992, and several meetings of provincial ministers. A comprehensive plan was put forward in May 1996 by the so-called "Group of 22," a panel of leading Canadian academics.

However, the proposal which has received the most attention was released as a discussion paper by the Province of Ontario before the August 1996 premiers' conference. Authored by Professor Thomas Courchene of Queen's University, the ACCESS paper³ (A Convention on the Canadian Economic and Social Systems), has provoked substantial reaction, both pos-

itive and negative, from premiers and journalists.

While interest in the ACCESS proposal has continued,⁴ relatively little attention has been paid to its fiscal implications. In a previous paper (Boothe and Hermanutz, 1997), we used 1994–95 data to examine the fiscal implications for the federal government and provincial governments as a group. The purpose of the present paper is to tackle a substantially more complex problem: the fiscal implications for each of the ten individual provinces. In addition, we have used data for 1996–97 to provide a more up-to-date picture of the fiscal implications of ACCESS.

The remainder of the paper is organized as follows. In Section 2, we briefly describe the current Canadian fiscal structure and examine how it has changed over the past decade. Our simple model of the federal fiscal structure is described in Section 3. In Section 4, we discuss the ACCESS principles for allocating expenditure powers and develop a corresponding set of principles for allocating revenues. Our data set and methodology are described in Section 5, and in Section 6 we present results for two versions of the ACCESS proposal, one with federal-provincial transfers (ACCESS F) and the other with interprovincial transfers (ACCESS P). Section 7 summarizes our results and offers some concluding comments.

2. THE CURRENT SITUATION

It is useful to begin our discussion of the fiscal implications of the ACCESS model with a review of the current structure of the Canadian fiscal system. The relevant data are presented in Table 1. Starting with expenditures, we see from Table 1 that provinces are dominant in program expenditures – providing 60 percent of this category. Program spending makes up about 71 percent of combined expenditures by federal and provincial governments. Although all governments provide some transfers to other governments, the federal government's transfers (8 percent of combined expenditure) make up 91 percent of this expenditure category. Debt service (21 percent of combined expenditure) is also dominated by the federal government (62 percent of this category). Combined expenditure is divided almost equally between the federal government and the provinces.

On the revenue side, the federal government is dominant in the personal income tax (PIT) field, taking 60 percent of this revenue category. Overall, PIT makes up 33 percent of combined revenue. Corporate income tax (CIT), which makes up 8 percent of combined revenue, is also dominated by the federal government (63 percent of CIT). Sales tax, which makes up 13 percent of combined revenue, is almost evenly split between federal and provincial governments⁵ as are excise taxes (7 percent of combined revenue). Payroll taxes, which make up 10 percent of combined revenue, are dominated by the federal government (57 percent of those categories). Other tax revenue (16 percent of total revenue) includes natural resource revenue and is dominated by the provinces (71 percent of the category). Transfers from other governments, which make up 8 percent of combined

Table 1
Government Expenditure 1996/97

	Federal	Nfld	PEI	NS	NB	Que	Ont	Man	Sask	Alta	BC	Provincial	Total
Programs	98,295	2,944	708	4,023	3,829	39,733	48,989	5,403	4,681	13,026	21,712	145,049	243,344
Transfers	23,814	44	5	33	139	565	919	162	89	221	116	2,291	26,105
Debt Service	45,184	704	134	951	849	7,636	9,801	1,476	1,298	1,935	2,708	27,492	72,676
Total	167,293	3,692	847	5,007	4,817	47,934	59,709	7,041	6,068	15,182	24,536	174,832	342,126

Government Revenue 1996/97

	Federal	Nfld	PEI	NS	NB	Que	Ont	Man	Sask	Alta	BC	Provincial	Total
PIT	68,521	618	130	956	830	13,602	17,483	1,458	1,277	3,443	5,360	45,157	113,678
CTT	16,855	78	21	126	236	1,844	4,207	253	272	1,407	1,471	9,914	26,769
Sales	20,923	556	129	747	734	5,300	9,767	820	847	-	3,059	21,960	42,883
Excise	11,018	258	61	411	286	2,326	4,331	475	484	1,344	1,954	11,932	22,950
Payroll	19,847	180	16	164	95	5,437	5,368	369	154	992	1,916	14,690	34,537
Other	16,063	498	193	696	1,203	7,328	8,036	1,950	2,346	8,938	8,586	39,773	55,836
Transfers	542	1,559	291	1,900	1,515	7,577	6,300	1,822	827	1,395	2,049	25,237	25,779
Net Borrowing	13,525	(55)	7	8	(82)	4,519	4,216	(106)	(140)	(2,337)	140	6,169	19,693
Total	167,293	3,692	847	5,007	4,817	47,934	59,709	7,041	6,068	15,182	24,536	174,832	342,126

Table 2
Provincial Per Capita Expenditures 1996/97

	Nfld	PEI	NS	NB	Que	Ont	Man	Sask	Alta	BC	Average
Programs	5,155	5,167	4,271	5,021	5,379	4,358	4,728	4,580	4,674	5,640	4,861
Transfers	76	33	35	182	76	82	142	87	79	30	77
Debt Service	1,233	980	1,010	1,114	1,034	872	1,291	1,269	694	704	921
Total	6,464	6,180	5,316	6,317	6,490	5,312	6,161	5,936	5,448	6,374	5,859

Provincial Per Capita Revenues 1996/97

	Nfld	PEI	NS	NB	Que	Ont	Man	Sask	Alta	BC	Average
PTT	1,082	950	1,014	1,089	1,842	1,555	1,276	1,249	1,235	1,392	1,513
CIT	136	151	134	310	250	374	222	266	505	382	332
Sales	974	943	793	963	718	869	718	829	-	795	736
Excise	452	441	437	375	315	385	416	474	482	508	400
Payroll	314	117	174	125	736	478	323	150	356	498	492
Other	872	1,405	739	1,577	992	715	1,706	2,295	3,207	2,230	1,333
Transfers	2,731	2,125	2,017	1,987	1,026	560	1,594	809	500	532	846
Net Borrowing	(97)	48	8	(108)	612	375	(92)	(137)	(838)	36	207
Total	6,464	6,180	5,316	6,317	6,490	5,312	6,161	5,936	5,448	6,374	5,859

revenue, are received almost exclusively by provincial governments. Net borrowing, which makes up 6 percent of combined revenue in 1996-97, is dominated by the federal government (69 percent of this category). Indeed, among provinces only Ontario and Quebec projected deficits in 1996-97 budgets.⁶

Provincial expenditures and revenues in Table 2 are expressed in per capita terms to ease comparison. Looking first at expenditures, we see that British Columbia has the highest level of program spending, while the lowest level of program spending is provided by Nova Scotia. Manitoba has the highest level of debt service payments, while Alberta has the lowest.

On the revenue side, Quebec collects the most income tax per capita as a result of its unique arrangement with the federal government related to transfers.⁷ It is followed by Ontario and British Columbia. The two other most important revenue categories are other revenue and transfers. The other revenue category, which includes natural resource revenue, is largest in Alberta. This revenue category is larger than PIT in six of ten provinces. Transfers are the largest source of per capita revenue in the four Atlantic provinces.

In Table 3 we see how federal shares of national expenditure and revenue have changed over the past four years. On the expenditure side, federal program expenditure has declined slightly (2 percentage points) over the decade as provincial program spending expanded. On the revenue side, we see a general decline in federal shares in all categories except sales tax. These declines are almost fully offset by the large increase in the federal government's share of net borrowing (8 percentage points).

Table 3
Federal Shares of Expenditure by Category

	1992-93	1996-97
Programs	42%	40%
Transfers	92%	91%
Debt Service	65%	62%
Total	50%	49%

Federal Shares of Revenue by Category

	1992-93	1996-97
PIT	63%	60%
CIT	65%	63%
Sales	48%	49%
Excise	50%	48%
Payroll	58%	57%
Other	33%	29%
Transfers	-	-
Net Borrowing	61%	69%
Total	50%	49%

What the data in Table 3 do not reveal, however, is the declining importance of transfers both as a federal expenditure and as a contribution to provincial programs. Over the four-year period, transfers declined as a share of total federal spending from 16 to 14 percent. Viewed from the provincial perspective, federal transfers contributed 19 percent of provincial program spending in 1992–93, compared with only 16 percent four years later. It is these latter two statistics which illustrate the significant ongoing changes underway in the fiscal structure of the Canadian federation.

Finally, a number of measures affecting federal-provincial fiscal relations that have been announced by the federal government have not yet been fully implemented. The most important of these is the introduction of the CHST in 1996–97 and the resulting dramatic decrease in federal transfers to the provinces. In the first year of the CHST, 1996–97, cash transfers fell to \$14.9 billion from \$18.6 billion in 1995–96. These are slated to fall further to \$12.5 billion in 1997–98 for an overall reduction of about \$6 billion, or one-third. The total CHST will remain at \$12.5 billion until at least 2002–03 according to the current federal policy.⁸

3. THE MODEL

As with any mature federation, actual fiscal relations between Canadian governments are extremely complex. To understand the process of designing a fiscal regime to support an alternative division of spending responsibilities, it is useful to build a simple model of a stylized federation.

Consider a federation with a federal government and two provinces. Expenditures and revenues for each government are divided into three categories. Expenditure categories for each government are program spending (*PE*), transfers to other governments (*TrE*), and debt service payments (*DS*). Revenue categories are taxes (*T*), transfers from other governments (*TrR*) and net borrowing (*NB*). We use the subscript 1 to denote the federal government, and subscripts 2 and 3 to denote the two provinces. Each government must respect its budget constraint:

$$T_i + TrR_i + NB_i = PE_i + TrE_i + DS_i \quad (1)$$

In words, revenues (including net borrowing) must equal expenditures (for all governments). In addition, a number of federation-wide constraints must be respected:

$$\begin{aligned} \sum_i T_i &= \bar{T} \\ \sum_i NB_i &= \bar{NB} \\ \sum_i PE_i &= \bar{PE} \end{aligned} \quad (2)$$

$$\sum_i DS_i = \overline{DS}$$

$$\sum_i TrR_i = \sum_i TrE$$

In words, the sum of individual taxes must equal the total taxes collected in the federation, and similarly for net borrowing, program expenditure, and debt service payments. We treat these four totals as exogenous. The final constraint is that the total transfers received by governments must equal the total transfers expended.

The policy choices which describe the fiscal structure of the federation are described by the following parameters: t_i , nb_i , trr_i , pe_i , ds_i , tre_i (for each government) where each parameter is equal to a particular government's share of total taxes, net borrowing, transfer revenue, program expenditure, debt service payments, or transfer expenditure. The constraints described in Equation (2) ensure that:

$$\sum_i t_i = 1 \quad (3)$$

and similarly for the other policy parameters.

We normalize the budget constraints (with policy parameters substituted in) on transfers and then solve the model. The adding-up constraints imply that only two of the three equations need to be solved. As an example, consider the case where the federal government has no transfer revenue ($trr_1 = 0$) and the provinces have no transfer expenditures ($tre_2 = tre_3 = 0$). In this case, the solution to the model is characterized as follows:

$$\begin{aligned} TrE_1 &= t_1 \bar{T} + nb_1 \bar{NB} - pe_1 \bar{PE} - ds_1 \bar{DS} \\ TrR_2 &= pe_2 \bar{PE} + ds_2 \bar{DS} - t_2 \bar{T} - nb_2 \bar{NB} \\ TrR_3 &= pe_3 \bar{PE} + ds_3 \bar{DS} - t_3 \bar{T} - nb_3 \bar{NB} \end{aligned} \quad (4)$$

where the third equation can be deduced directly from the first two.

To use the model to examine the implications of an alternative fiscal regime, one simply posits an alternative set of policy parameters and solves for transfers. Of course, the choice of policy parameter set will depend on the goal of the policy change. For example, given a distribution of spending responsibilities, debt service payments, and net borrowing (pe_i, ds_i, nb_i), one could choose a distribution of taxes revenues (t_i) to minimize, say, vertical fiscal imbalance (as measured by the ratio of transfer revenue to total expenditure). To model a move from a federal-provincial transfer scheme to one based on inter-provincial transfers, one would set $trr_1 = tre_1 = 0$ and allow $tre_2 > 0$.

In this simplified model, an analytical solution is readily derived.

However, with ten provinces and numerous revenue and expenditure categories, the model is analytically intractable. In this case, numerical methods are the preferred solution technique.

4. PRINCIPLES FOR ASSIGNING EXPENDITURES AND TAXES⁹

The assignment of expenditure responsibilities and revenue fields to federal and provincial governments is the subject of ongoing debate in Canada. A number of recent academic studies have considered the assignment of expenditures, and the provinces (except Quebec) presented their general views on social policy assignment in the 1995 *Report to Premiers*.

The ACCESS proposal lists principles to guide the assignment of expenditure responsibilities:

- 1 Expenditure assignments must respect the Canadian Constitution,
- 2 Subsidiarity, and
- 3 Fiscal equity.

The first principle reflects the desire to avoid making constitutional change a requirement of fiscal reform. This recognizes that requiring constitutional change substantially lowers the likelihood that fiscal reforms will be adopted. The second principle, subsidiarity, requires that government decisions be made as close to citizens as is consistent with the efficient delivery of services. This principle reflects a desire to enhance the responsiveness and accountability of governments to citizens. The final principle, fiscal equity, prohibits the federal government from discriminating among its citizens on the basis of geographical location or criteria that imply geographical discrimination. The constitutionally sanctioned federal equalization program, which equalizes revenues among provincial governments, is an important exception to this principle.

Principles for assigning taxation responsibilities have also been the subject of much academic study in Canada.¹¹ In the ACCESS proposal, the only explicit principle for revenue assignment is that federal cash transfers (excepting equalization) be converted into equalized tax points. To make the proposal operational on the revenue side, we add the following four principles from Boothe and Hermanutz (1997) which we believe are consistent with the thrust of the proposal:

- 4 Except when government programs are designed explicitly for the purposes of redistribution, people who benefit from government programs should pay for them. (Benefit taxation)
- 5 Where possible, the government which provides a service should raise the revenue to finance that service. (Fiscal coincidence)
- 6 The most mobile tax bases should be assigned to the federal government to minimize tax avoidance. (Minimize tax base flight)

- 7 Where possible, redistributive programs should be financed by redistributive taxes. (Tax and expenditure systems should work together)

The operational implications of these principles are explored in the next section.

5. EXPENDITURE AND TAX ASSIGNMENTS IN ACCESS

In order to examine the implications of the ACCESS expenditure principles, a number of choices must be made. Given the availability of data, the reassignment of expenditures can only be done at a high level of aggregation. A set of choices we believe are broadly consistent with the ACCESS expenditure principles is presented in Table 4. Federal responsibilities include:

- a) Redistribution to individuals. Examples include income support for seniors, such as Old Age Security and Guaranteed Income Supplement, and income support for children.
- b) National programs. Examples include defence, foreign affairs, national culture (CBC, national museums and parks), and the non-training component of Employment Insurance (EI).¹²
- c) Federal debt service.
- d) Equalization. All revenues reassigned to provinces are equalized based on the current five-province standard. Assigning equalization to the federal government distinguishes the ACCESS F from the ACCESS P proposal. In ACCESS P, equalization is assigned to the provinces.

Table 4
ACCESS Expenditure Assignment

<i>Program</i>	<i>Federal</i>	<i>Provincial</i>
Redistribution to Individuals	X	
National Programs		
e.g. defense	X	
foreign affairs	X	
national culture	X	
EI	X	
Federal debt service	X	
Local Programs		
e.g. health		X
education		X
social services		X
training		X
infrastructure		X
Provincial debt service		X
Federal-Provincial Equalization*	X	
Inter-provincial Equalization**		X

*ACCESS F only; ** ACCESS P only.

Provincial responsibilities include:

- a) Local programs. Examples include health, education, social services, training, and infrastructure.
- b) Provincial debt service.
- c) Equalization. This program is assigned to the provinces in ACCESS P.

In keeping with the principle of subsidiarity, most government services are delivered at the provincial or local level. Production of these services is generally labour-intensive and exhibits only local economies of scale, and most are delivered by the provinces currently.¹³ National programs are those for which there are large economies of scale (foreign affairs) and where services are "national" public goods (defence) or make sense for insurance purposes (EI). In addition, for reasons of national equity, the main expenditure programs for redistribution among individuals (programs for seniors and current provincial programs for children from low-income families) are delivered by the federal government.¹⁴ The federal government services the national debt and provides equalization to provinces using the current formula. Thus, under this proposal all provincial tax revenues are equalized according to the five-province standard. Specific-purpose transfers from the federal government to the provinces, mainly the CHST, are eliminated.

The details of our ACCESS expenditure assignment are shown in Table 5. From this table it is clear that ACCESS does not imply only transferring federal expenditures to the provinces – some expenditures are also transferred from the provinces to the federal government. All expenditures that are transferred from the federal government to the provinces were done on a per capita basis. The actual incidence of these expenditures is probably not equal per capita; however, given the amounts transferred, the differences are not likely that large in the overall picture.

Table 5
Expenditure Transfers under ACCESS (millions)

	<i>To federal</i>	<i>To provinces</i>
Health		1,189
Social Services		
Seniors	500	
Child Benefits	2,000	
EI Developmental		2,500
Education		3,977
Environment		745
Labour, employment and immigration	1,000	
Housing		1,973
Regional planning and development	950	
Sub-Total	2,500	12,334
Total Transfer		9,834

Overall, \$9.8 billion in program expenditure is shifted from the federal government to the provinces. This is the net result of shifting \$12.3 billion to the provinces and \$2.5 billion to the federal government. Seniors' programs and child benefits are transferred to the federal government, consistent with their function of income redistribution. Federal spending on health, EI developmental, education, environment, housing, and regional planning and development are allocated to the provinces. As well, \$1 billion of the \$1.7 billion federal spending on labour, employment and immigration is transferred to the provinces. This is a rough approximation of the split between labour/employment and immigration, leaving immigration with the federal government.

Table 6
ACCESS Revenue Assignment

<i>Revenue Category</i>	<i>Federal</i>	<i>Provincial</i>
PIT*	x	X
CIT	X	
Sales	X	
Excise	x	X
Payroll	X	x
Other	X	x
Other	X	x
Transfers**	X	X
Net Borrowing	X	x

*Uppercase denotes dominant occupant

** Depending on whether ACCESS F or ACCESS P is implemented.

The implications of our revenue assignment principles are summarized in Table 6:

- a) PIT: shared by both levels of government, with provinces being the dominant occupant of this field. This revenue source is notionally assigned to finance programs that include a large redistributive component, i.e. health, education, and social services by provinces, and transfers to individuals by Ottawa.
- b) CIT: this highly mobile tax base is assigned solely to the federal government.
- c) Sales tax: assigned solely to the federal government to reduce administration and compliance costs.
- d) Excise taxes: shared by both levels of government with provinces dominant in this field. These revenues are notionally matched with infrastructure programs (e.g., the gasoline tax finances transportation expenditure).
- e) Payroll: shared by both levels of government with Ottawa dominant in this field. The federal portion is used to fund the insurance portion of

EI, while the remaining EI premiums are transferred to the provinces to fund training.

- f) Other: shared by governments at both levels with provinces dominant in this field. No changes are proposed without analysis of more disaggregated data. Natural resource revenues are included in this category.
- g) Net borrowing: held constant under the ACCESS proposal.

The details of our revenue assignment are shown in Table 7. Overall, under ACCESS F we shift \$21.1 billion in revenues from the federal government to the provinces. This is the net result of shifting \$53 billion to the provinces and \$31.9 billion to the federal government. Under ACCESS P we shift \$37.6 billion net to the provinces, with the difference being an increased share of the PIT for the provinces.

When allocating federal revenues among the provinces we use the shares of federal revenue for that source collected in each province. Therefore, in those cases, there is no impact on taxpayers in each province. However, for the CIT and sales tax we simply transfer the provincial amount to the federal government. No attempt is made to compare federal shares with provincial shares to see how provincial taxpayers would fare.

Table 7
Revenue Assignment under ACCESS (millions)

<i>ACCESS F</i>	<i>To federal</i>	<i>To provinces</i>
PIT		35,244
CIT	9,914	
Sales	21,960	
Excise		11,018
Payroll		6,747
Other		-
Transfers		-
Net Borrowing		-
Sub-Total	31,874	53,009
Total Transfer	-	21,135
<i>ACCESS P</i>	<i>To federal</i>	<i>To provinces</i>
PIT		51,757
CIT	9,914	
Sales	21,960	
Excise		11,018
Payroll		6,747
Other		-
Transfers		-
Net Borrowing		-
Sub-Total	31,874	69,522
Total Transfer	-	37,648

One adjustment is worthy of note. Our methodology assumes that the federal government would collect a sales tax across all provinces. Since Alberta does not have a provincial sales tax, we calculated the amount of additional national sales tax that would be collected in Alberta (\$2.5 billion) and reduced personal income taxes by that amount, essentially granting a provincial income tax abatement to Albertans. To ensure that total revenues add up, this amount was then added to the total sales tax revenue.

6. RESULTS

The fiscal implications of ACCESS for the federal government and provinces as a group are presented in Table 8. We see that the expenditure principles embodied in ACCESS imply a decline in the federal share of national program spending of about \$9.8 billion, or from 40 to 36 percent. Federal transfers to provinces decline by about \$7.3 billion to \$16.5 billion under ACCESS F and to zero under ACCESS P. Overall, federal spending falls from 49 percent of total combined spending to about 45 percent under ACCESS F and to 41 percent under ACCESS P.

Table 8
Government Expenditure under ACCESS

	1996/97		ACCESS F		ACCESS P	
	Federal	Provincial	Federal	Provincial	Federal	Provincial
Programs	98,295	145,049	88,461	154,883	88,461	154,883
Transfers	23,814	2,291	16,513	2,291	-	12,827
Debt Service	45,184	27,492	45,184	27,492	45,184	27,492
Total	167,293	174,832	150,158	184,666	133,645	195,202

Government Revenue under ACCESS

	1996/97		ACCESS F		ACCESS P	
	Federal	Provincial	Federal	Provincial	Federal	Provincial
PIT	68,521	45,157	31,277	79,943	14,764	96,456
CIT	16,855	9,914	26,769	-	26,769	-
Sales	20,923	21,960	45,342	-	45,342	-
Excise	11,018	11,932	3,541	19,409	3,541	19,409
Payroll	19,847	14,690	13,100	21,437	13,100	21,437
Other	16,063	39,773	16,063	39,773	16,063	39,773
Transfers	542	25,237	542	17,936	542	11,958
Net Borrowing	13,525	6,169	13,524	6,168	13,524	6,169
Total	167,293	174,832	150,158	184,666	133,645	195,202

Table 9
Changes in Provincial Expenditure under ACCESS F

	<i>Nfld</i>	<i>PEI</i>	<i>NS</i>	<i>NB</i>	<i>Que</i>	<i>Ont</i>	<i>Man</i>	<i>Sask</i>	<i>Alta</i>	<i>BC</i>	<i>Total</i>
Programs	188	45	310	251	2,434	3,704	377	337	918	1,269	9,834
Transfers	-	-	-	-	-	-	-	-	-	-	-
Debt Service	-	-	-	-	-	-	-	-	-	-	-
Total	188	45	310	251	2,434	3,704	377	337	918	1,269	9,834

Changes in Provincial Expenditure under ACCESS P

	<i>Nfld</i>	<i>PEI</i>	<i>NS</i>	<i>NB</i>	<i>Que</i>	<i>Ont</i>	<i>Man</i>	<i>Sask</i>	<i>Alta</i>	<i>BC</i>	<i>Total</i>
Programs	188	45	310	251	2,434	3,704	377	337	918	1,269	9,834
Transfers	-	-	-	-	-	6,897	-	-	1,285	2,353	10,536
Debt Service	-	-	-	-	-	-	-	-	-	-	-
Total	188	45	310	251	2,434	10,601	377	337	2,204	3,622	20,370

Table 10
Changes in Provincial Revenue under ACCESS F

	Nfld	PEI	NS	NB	Que	Ont	Man	Sask	Alta	BC	Total
PIT	522 (78)	129 (21)	1,001 (126)	783 (236)	4,977 (1,844)	17,654 (4,207)	1,333 (253)	1,097 (272)	1,641 (1,407)	5,648 (1,471)	34,785 (9,914)
CIT	(556)	(129)	(747)	(734)	(5,300)	(9,767)	(820)	(847)	-	(3,059)	(21,960)
Sales	135	31	241	208	1,548	2,694	267	187	945	1,222	7,477
Excise	97	26	182	152	1,585	2,738	241	185	648	894	6,747
Payroll	-	-	-	-	-	-	-	-	-	-	-
Other	-	-	-	-	-	-	-	-	-	-	-
Transfers	69	9	(240)	78	1,469	(5,407)	(392)	(13)	(909)	(1,966)	(7,301)
Net Borrowing	-	-	-	-	-	-	-	-	-	-	-
Total	188	45	310	251	2,434	3,704	377	337	918	1,269	9,834

Changes in Provincial Revenue under ACCESS P

[illegible]

Table 11
ACCESS Lump-Sum Transfers versus Implied Equalization

	Nfld	PEI	NS	NB	Que	Ont	Man	Sask	Alta	BC
Current Equalization	956	188	1,129	904	4,017	-	1,039	259	-	-
ACCESS F Transfer	1,596	207	1,643	1,479	8,955	439	1,052	705	436	-
Implied Gross Equalization	1,231	240	1,396	1,192	5,989	-	1,297	505	-	-
ACCESS P Transfer	1,381	153	1,226	1,155	5,862	(6,897)	502	255	(1,285)	(2,353)
Implied Net Equalization	1,194	222	1,181	1,041	4,044	(4,988)	1,027	326	(1,243)	(1,575)

On the revenue side, federal PIT revenues fall by about \$37.2 billion to \$31.3 billion under ACCESS F and by about \$53.7 billion to \$14.8 billion under ACCESS P. This reduces the federal share of national PIT from 60 to 28 percent under ACCESS F and to 13 percent under ACCESS P. The federal government becomes the sole occupant of the CIT and sales tax fields. By construction, the federal shares of national revenue fall by the same amounts as expenditures discussed above.

A more in-depth look at the expenditure implications for the provinces is presented in Table 9. In general, provincial program expenditures grow in the range of 6–8 percent under ACCESS relative to their 1996–97 values. The growth of total spending is in the 5–6 percent range under ACCESS F. Under ACCESS P, the three contributing provinces, British Columbia, Alberta, and Ontario, all have relatively large increases in transfer expenditures, so that total expenditures for those provinces rise by 15–18 percent.

In Table 10 we look more closely at the implications of ACCESS for provincial revenues. All provinces gain substantial PIT revenues at the expense of CIT and sales taxes. The PIT gain is larger for ACCESS P than ACCESS F since additional revenues are required to fund the interprovincial transfer scheme. Transfers decline substantially across the board under ACCESS P as provinces replace federal transfers with own-source revenue.

In Table 11 we compare the lump-sum transfers under ACCESS F and ACCESS P with those that would have obtained using the current equalization formula and reallocated revenues. Looking first at ACCESS F, we note the relatively close correspondence of lump-sum transfers to recipient provinces with the implied equalization. In all cases except Prince Edward Island and Manitoba, recipient provinces get more under the lump-sum transfer than under equalization. The difference between the two transfers provides one measure of the amount of "equalization" included in current federal transfers beyond the formal equalization program.¹⁵

Under ACCESS P, the lump-sum transfer is generally smaller than under ACCESS F, since a larger share of PIT revenue has been allocated to the provinces. The interprovincial scheme embedded in ACCESS P is a "net" equalization scheme, so we have compared it with a modified equalization scheme based on net (i.e., negative as well as positive) entitlements. Although the distribution of differences among provinces changes somewhat, in general, the lump-sum transfer and the implied equalization are closer under ACCESS P than ACCESS F.

7. CONCLUDING COMMENTS AND FUTURE WORK

In this paper we have examined the fiscal implications of Courchene's ACCESS proposal for individual provinces based on 1996–97 FMS data. The results of our examination are easily summarized.

Based on principles consistent with the ACCESS proposal, the federal government is responsible for expenditures relating to transfers to individuals,

and national programs such as defence, foreign affairs, and EI. Provincial governments are responsible for expenditures relating to regional programs including health, education, social services, training and infrastructure.

On the revenue side, principles consistent with the ACCESS proposal led us to assign the CIT and sales tax fields solely to the federal government, and a larger share of the PIT to provincial governments. We consider two variations for intergovernmental transfers, one based on federal-provincial transfers (ACCESS F) and another based on interprovincial transfers (ACCESS P). In both cases we calculated the lump-sum transfers required to restore all governments to their estimated 1996-97 surplus/deficit position.

As in our previous work based on 1994-95 data, we found that the expenditure shifts needed to implement the ACCESS proposal were surprisingly small. Indeed the federal-provincial shares of total expenditure change by only 4 percentage points from 49:51 to 45:55, and provincial program expenditures rise by only 6 to 8 percent.

On the revenue side, federal-provincial shares change more markedly. PIT shares change from 60:40 to 28:72 under ACCESS F and to 13:87 under ACCESS P. This shift of PIT is offset by changes in CIT shares (from 63:37 to 100:0) and sales tax shares (from 49:51 to 100:0). About 60 percent of the total shift (under ACCESS F) is used to finance the reallocation of program expenditures, with the rest being used to reduce vertical fiscal imbalance (VFI). VFI is reduced from its current level of 13.6 percent to 8.9 percent under ACCESS F, and it is eliminated under ACCESS P.

Looking at individual provinces, we demonstrate that it is possible to calculate a set of lump-sum intergovernmental transfers which restore all governments to their 1996-97 surplus/deficit positions under ACCESS. Indeed, these transfers are of the same magnitude as the transfers generated by the current equalization formula applied to the ACCESS revenue allocation. In general, the required lump-sum transfers are larger than the implied equalization because of the unequal per capita nature of current federal transfers (especially the CHST) outside of equalization.

Finally, two areas for future work are suggested by this study. The first is to compare the dynamic implications of the current expenditure/revenue mix with the mix implied by ACCESS. This is needed to give some guidance as to dynamic stability (revenues and expenditures matching over time) of the alternative schemes. The second is to examine in more depth what kinds of transfer systems would support the reallocation of expenditures and revenues embodied in ACCESS.

Notes

- 1 The federal block-fund transfer contributing to programs for health and post-secondary education.

- 2 For example, see the discussion in Hobson and St-Hilaire, 1994.
- 3 The paper was subsequently published in a 1996 issue of *Canadian Business Economics*.
- 4 The proposal was the subject of a 1996 conference and panel sessions and presentations at the 1997 Learned Societies' meetings in St. John's, Newfoundland.
- 5 Only Alberta does not occupy the general sales tax field.
- 6 In addition, B.C., P.E.I. and Nova Scotia posted deficits (based on FMS accounting conventions) for 1996-97.
- 7 Quebec receives approximately \$2 billion of CHST entitlement in the form of a tax abatement.
- 8 Unlike its predecessor, the block-funded Established Programs Financing, CHST is not allocated on an equal per capita basis – there are wide variations in provincial transfers. For example, in 1997–98, the CHST varied from \$335 per capita in Alberta to \$514 per capita in Quebec. These differences cause significant inter-provincial redistribution when we replace the CHST cash transfer with tax points under ACCESS. For further reading on the CHST and its allocation, see Bossenkool, 1996; Hermanutz, Robertson and Smith, 1996.
- 9 The next two sections draw heavily on Boothe and Hermanutz, 1997.
- 10 For example, see Boothe, 1991; Norrie, Boadway and Osberg, 1991; Boadway, 1993.
- 11 See, for example, the Allaire Report (1991) of the Quebec Liberal Party's Constitutional Committee; Mintz and Wilson, 1991; Dahlby, 1992; Ip and Mintz, 1992; Ruggeri, Howard and Van Wart, 1993; and Ruggeri, Van Wart, Robertson and Howard, 1993. For a brief review of this literature, see Boothe and Hermanutz, 1997.
- 12 Here we differ from ACCESS, which transfers EI to the provinces. Our approach is consistent with the current constitution. In keeping with the principle of fiscal equity, EI payments to individuals could not vary according to location.
- 13 Because a number of federal programs delivered to Aboriginals cannot be identified specifically within the FMS data, we have transferred them to the provinces. Constitutionally, these programs are federal. While the programs should probably be *delivered* by the provinces for efficiency reasons, whether they should be financed by provincial taxes, federal grants to provinces, or purchased by First Nations is outside the scope of our paper.
- 14 Note, however, that social services remain with provinces. This assignment is designed to allow integration with training and health services, and respects the constitution.
- 15 It is important to note here that this measure is not unique, i.e., it is dependent on the particular distribution of revenues embedded in ACCESS F.

COMMENTS ON PAUL BOOTHE AND
DEREK HERMANUTZ'S PAPER
HARVEY LAZAR

The paper is nicely organized and the presentation is generally clear. The criteria that guide the reallocation of expenditures and revenue between the federal and provincial governments are stated clearly. The arithmetic results are then presented as relatively straightforward outcomes of the choices the authors make in applying the criteria. If their choices are accepted, in some sense that limits what can usefully be said about the paper.

The comments below are generally of two types. One relates to concerns about the way in which the criteria are applied. In this regard, the paper focuses on the magnitude of the shift of expenditure between orders of government that is required to implement ACCESS and the apparent relative simplicity of shifting revenue bases between orders of government to get the desired results. However, the paper is "underargued" in explaining and justifying the way in which the criteria are implemented. The result is to leave the reader somewhat uneasy about the numbers that derive from the approach.

Second, in various places, the paper is too vague about what is being done (even though in general it is remarkably clear). This difficulty may not be serious for those steeped in public finance. But for others, more clarity would be helpful.

1. CURRENT SITUATION

The text notes that federal transfers have declined as a share of total federal spending from 16 to 14 percent. It might be equally useful to note what has happened to transfers as a share of federal program spending so that the reader knows the extent to which federal cutbacks in transfers to the provinces exceed in the aggregate reductions in the federal government's own programs.

2. EXPENDITURE ALLOCATION

The principles that underlie the allocation of expenditures are specified on page 82. The authors note on page 84 that all expenditures transferred from the federal government to the provinces were done on a (I presume equal) per capita basis even though the actual incidence of these expenditures may not be entirely equal. Boothe and Hermanutz feel that the impact on the overall picture is not large. In the aggregate this may be true, but for smaller provinces that currently benefit from unequal per capita distributions of CHST, labour market training dollars, and so on, the impact may be more significant.

More important, it is not obvious why the authors did not transfer social

Decentralization in Health Policy: Comments on the ACCESS Proposals

ANTONIA MAIONI

Health policy is at once the least and the most controversial policy sector in the debate over decentralization. It is least controversial in the lofty sense that, according to the mantra of values and "identity," Canadians share an attachment to public administration, universality, comprehensiveness, and portability in health care. In the rough and real world of intergovernmental politics, however, decentralization in health care represents a controversial struggle for full sovereignty in a public sector where the political and financial stakes are the highest of all. Health care is a policy area in which government decisions can have immediate consequence on people's lives and significant effects on provincial treasuries. And, unlike many other social services, policy decisions in the health-care sector involve negotiation with powerful stakeholders and the presence of genuine alternatives to the public sector.

The intensified debate about decentralization and the revival of interest in the idea of a "social union" has encouraged provincial governments to consider new ways of redesigning the processes of intergovernmental affairs in Canada. In the fray of new ideas and proposals, economist Thomas Courchene was commissioned by the Government of Ontario to generate recommendations about how these processes might work. Courchene's response was to design an ACCESS model – "A Convention on the Canadian Economic and Social Systems."

Courchene's report argues that pressures for decentralization, including those in the area of health care, have led to the need for a new intergovernmental arrangement. These pressures stem from two main forces: globalization, or more precisely, the countervailing pressures of north-south economic integration upon existing east-west linkages in Canada; and fiscal downsizing, which is eroding Ottawa's powers in social policy. According to Courchene, these pressures risk jeopardizing the Canadian economic and social union; therefore, something must be done to avoid this outcome. His solution to preserve the social and economic union is to redesign federalism in such a way as to replace Ottawa's "enforcer" role with an interprovincial

"convention" (1996a: 2).

My task in this paper is to describe and evaluate how this might work in the area of health policy, arguably the most important element of the social system Courchene's ACCESS model is designed to preserve. To do so, I draw on my background as a political scientist interested in political history and in macro-level analyses of policy-making. This paper briefly describes the development of health insurance in Canada, evaluates the present arrangements in the health-care system according to Courchene's framework axioms, and discusses whether the type of decentralization Courchene is proposing is feasible. The analysis leads me to conclude that the political obstacles to achieving a consensus on health policy are substantial because of divergent "norms" and that, even if such a consensus were possible, the incentives for provinces to adhere to an agreement on health-care systems are weak at best. In effect, the interprovincial arrangement Courchene proposes in the ACCESS model would not lead to the preservation of a social and economic union, but to something very different.

HISTORICAL BACKGROUND

Courchene's historical analysis can be summed up briefly in his own words: "Securing the socio-economic union in postwar Canada was essentially left to Ottawa" (1996a: 4). This postwar era, at least until the late 1960s, was a very different period than the one we live in today. Specifically, it was a time in which states in industrialized countries were engaging in more extensive forms of social and economic intervention, buoyed by the discourse of "social rights" coming out of the postwar reconstruction experience, the widespread acceptance of Keynesian macroeconomic principles, and the economic prosperity that encouraged governments to substantially increase public spending.

In effect, two major forces contributed to the development of health insurance in the provinces: partisan politics and the design of Canadian federalism itself (Maioni, 1997). Partisan politics are important because it was a political party of the left, namely the CCF-NDP in Saskatchewan, that inaugurated the first government-sponsored hospital insurance (1947) and medical insurance (1962) systems in North America. The success of these innovations, combined with the political pressure exerted by the CCF-NDP's federal counterpart, was pivotal in convincing successive Liberal governments to deploy the federal spending power on condition that the provinces would agree to design hospital (1957) and later medical (1966) insurance systems largely inspired by the Saskatchewan model.

Federalism can exert a deterrence function in social policy development due to the fragmentation of power between competing orders of government (Banting, 1987). In the case of health policy, however, federalism can also serve as an innovative force by encouraging experimentation (Gray, 1991). The provinces have responsibility for health care through the Constitution Act of 1867, which gives the provinces exclusive jurisdiction in social mat-

ters, including hospitals (section 92.7) and local and private matters (section 92.16). There are two reasons why these powers were allocated to the provinces. First, they were not deemed to be very important in 1867, since state intervention in the social lives of citizens was limited, to say the least (Stevenson, 1985). Second, contingencies such as sickness, old age, and poverty were considered private matters, attended to by the family. Under poor-law traditions imported to the colonies from Britain, if these became "public" matters, the funding of charitable institutions (such as public hospitals) was undertaken by municipalities or, as in the case of Quebec, by religious communities (Guest, 1997).

This being said, it is not clear that Ottawa automatically filled a void left by the absence of provincial innovation in the area of health care. During the 1930s, there were relatively few bold responses to the Great Depression for both fiscal and jurisdictional reasons. The Liberal government, for example, refused to help finance initiatives such as British Columbia's health plan in 1936; while Prime Minister Bennett's Employment and Social Insurance Act was declared *ultra vires* by the Judicial Committee of the Privy Council in 1937. The Rowell-Sirois Report in 1940 suggested the federal government had a fiscal role to play in social policy, but reiterated the provinces' primary responsibility in developing their own health-care, education, and welfare systems (Smiley, 1962). Even though the federal government seemed to be moving towards a proactive stance towards social reform through the release of the 1943 Marsh report, the 1944 Throne Speech, and the 1945 Dominion-Provincial Conference on Reconstruction, it proved unable or unwilling to implement a "national" welfare state. In this context, then, it was up to the provinces to innovate in health care (as did Saskatchewan in 1947) in the absence of any federal initiative, or to push the federal government (as did Ontario in 1955) to share in the costs of such programs (Taylor, 1987).

Federal cost-sharing programs in both hospital and medical insurance came about as federal legislation following federal-provincial discussions in which autonomy was not the only issue. Indeed, part of the federal government's rationale for engaging in such cost-sharing was to mitigate the potential for a "crazy-quilt" of provincial health-insurance programs. There was some dissent from specific provinces. For example, the Union nationale government in Quebec argued hospital insurance was a provincial – and, more specifically, a private – matter, and the Social Credit government in Alberta considered voluntary medical insurance through "Manningcare" to be a better alternative than public control. Nevertheless, the conditions that the federal government attached to these cost-sharing arrangements were respected by provincial governments as they individually designed medical-care plans, albeit grudgingly by some (such as Ontario), or were supplemented by even more stringent conditions (such as Quebec). By 1971, public hospital- and medical-insurance plans were in operation in all the provinces. In this way, the federal government acted as the agent for the diffusion of the public, universal, and comprehensive model developed by a

social-democratic government in Saskatchewan. By insisting on these conditions, and on the portability of benefits for all Canadians, the federal government used the federal spending power to shape policy-making in a provincial jurisdiction so as to avoid the development of excessive differentiation in provincial health-care systems. Thus, the goal was not to impose uniformity in the playing field, since provincial plans demonstrate varying degrees of diversity, but rather to make sure that the provinces played by the same rules of the game and to ensure that Canadian taxpayers' money would be used to help finance publicly accountable health-insurance systems that ensured some sort of equality of social rights among Canadian citizens, regardless of their province of residence.

Since 1971, there has been some bending of the rules of this intergovernmental game. Through the 1957 Hospital Insurance and Diagnostic Services Act and the 1966 Medical Care Insurance Act, the provinces signed on to cost-sharing arrangements with the federal government. In 1977, however, these were modified to reflect a new per capita formula under the Established Programs Financing (EPF) arrangement. In addition to the fact that they were now responsible for increases in spending, the provinces also assumed this meant more flexibility in terms of financing the costs of their health-care systems. They were disabused of this notion in 1984 by the passage of the Canada Health Act (CHA). The CHA served to amalgamate existing federal hospital- and medical-insurance legislation, reinforce the existing conditions regulating health transfers under the EPF, and impose another, that of "accessibility." This new condition was to be enforced by explicit federal standards which prohibited the imposition of user fees or the toleration of extra-billing by the provinces, on penalty of dollar-by-dollar deductions to cash transfers. To the defenders of public health insurance, this insistence on uniform terms and conditions is essential because the use of deterrent charges violates the principle of equal access, while extra-billing allows physicians to play by two sets of rules and pump extra costs into the health-care system (Evans, 1990). To some provincial governments, however, the CHA represented an even graver violation of the rules of the intergovernmental game and of provincial sovereignty in health care (in particular, Quebec, which had long demanded federal withdrawal from areas of provincial jurisdiction, including health care).

With the spectre of federal sanctions, provinces were persuaded to ban user fees and extra-billing (except in Quebec, where such bans were already in effect), although in the case of Ontario, the medical association was not easily persuaded (Tuohy, 1988). It seemed to many provincial governments, however, that the idea of mutual consent between levels of government had been cast aside and that the federal government was overstepping its power to spend in provincial areas of jurisdiction by, in effect, stipulating the scope of provincial health-care policy. This feeling grew more pronounced as the federal government, burdened by deficits and mounting debt, decided to reduce its fiscal responsibilities in part by reducing cash transfers to the provinces. Successive federal governments, beginning in 1982, reduced,

then froze, then cut EPF transfers while at the same time insisting that the provinces still abide by the conditions of the CHA. The *coup de grâce* in this regard was the 1995 federal budget which announced that funding for provincial health systems would be amalgamated into a super-grant, the Canada Health and Social Transfer (CHST), which would substantially reduce the cash portion of federal transfers (O'Neill 1997).

Regardless of whether provincial governments felt there was too little or more than enough public money being spent on health care, these unilateral decisions, made to respond to federal budget imperatives buttressed by financial markets and political pressure from the right, profoundly affected provincial capacities to finance and budget for health-care spending. The political repercussions were twofold. First, in terms of intergovernmental relations, all the provinces signalled dissatisfaction with a federal budget decision that changed, virtually without consultation, the fiscal rules of the health policy game and, in addition, was widely seen as a way of "off-loading" the federal deficit to the provinces (Ministerial Council on Social Policy Reform and Renewal, 1995: 11). Second, in terms of partisan politics, such a move offered a political opportunity for parties and provincial governments that believed in less state intervention (or, in the case of Quebec, less *federal* intervention) to question the legitimacy of the imposition of federal standards on the provinces through the CHA, and to justify their attempts to explore other options for financing health care, including private market alternatives.

A forum for intergovernmental discussion of the issues facing the health-care sector might have been the National Forum on Health, except that most provinces refused the invitation to participate in this federal initiative in what is, formally, a provincial area of jurisdiction. In its 1997 report, the Forum insisted, quite emphatically, that the federal government had an essential role to play in ensuring the continuation of a successful public health-insurance system by upholding the five principles of the Canada Health Act. In order to do so, however, the Forum urged more institutionalized cooperation between federal and provincial governments, an end to federal imposition of change on the provinces, and, in addition, a guarantee of a minimum floor of cash transfers to help finance health-care systems (National Forum on Health, 1997).

The provinces, meanwhile, initiated their own forum for discussion of how to change the process of health policy through decentralization. Several political factors contributed to this bold new stance by the provincial governments: the perception of federal intransigence in health policy and the unilateral changes imposed through the CHST; the ideological disposition of activist Conservative governments in Ontario and Alberta; the legacy of "megaconstitutional" politics which had empowered provincial premiers as "national" political leaders; and the crisis of national unity, which at once made urgent the need for change in intergovernmental affairs and legitimized the quest for provincial autonomy.

Since the 1995 annual premiers' conference, provincial premiers demon-

strated the intention to take a leadership role in social policy renewal, a process that would involve further decentralization in health policy. The 1995 Ministerial Council's *Report to Premiers*, for example, reflected concerns about the federal government's ability and willingness to act unilaterally, and gave an indication of how decentralization could work to overcome this – through federal-provincial discussions to define the Canada Health Act, federal-provincial consultation to interpret the CHA and resolve disputes over its meaning, and a predictable funding base for health services through a guarantee that cuts in transfers to the provinces should not exceed federal expenditure cuts.

At the 1996 premiers' conference, a Provincial/Territorial Council on Social Policy Renewal was set up specifically to address the ways in which provinces could be more engaged in standard-setting and put an end to federal unilateralism. The Council's 1997 report, *New Approaches to Canada's Social Union*, stressed the need for provincial input to identify and enforce "shared" principles, establish procedural ground rules for intergovernmental cooperation, and develop new joint mechanisms for dispute resolution.

In the health-care field, provincial and territorial ministers of health (with the exception of Quebec) unveiled a *Renewed Vision for Canada's Health System* in January 1997, as requested by the premiers at their 1996 meeting in Jasper. This document observed, among other things, that an effective partnership between the federal and provincial governments would entail "adequate, predictable and stable cash transfers" and new, formal mechanisms to ensure more transparency and less ambiguity in dispute resolution.

What are these various reports designed to change? The following section looks at existing provincial and federal roles in the Canadian health-care system and evaluates them against the proposals in these reports, particularly Courchene's ACCESS document.

HEALTH-CARE SYSTEMS IN CANADA TODAY

Although many observers, including Courchene, refer to "national health insurance," this is not an accurate description of the Canadian experience. There is no "national" health-care system in Canada because no central government created or administers provincial and territorial health-care systems. Nor are the five principles of the Canada Health Act "national" standards. They are federal standards imposed to guarantee a set of principles that the provinces agree to abide by in designing and financing their health-insurance plans. What remains "Canadian" about the Canadian health-care system is that it is made up of twelve different health-care systems bound together by something; that something today is federal enforcement.

The Federal Role in Health Care

As was pointed out earlier, the jurisdictional role of the federal government in health policy is quite limited. (The federal government is responsible for

Aboriginal health care, another point of contention with the provinces, but one that will not be discussed here.) In addition, its *de facto* role in the actual provision of health-care services is also minimal. However, it must be recognized that the federal government does occupy a significant political space in the health sector. The most important manifestation of this is the Canada Health Act.

The legal scope of the CHA is limited to the cash transfers the federal government is prepared to deploy. The symbolic scope of the CHA, however, goes much farther. The CHA allocates a prominent place for the federal government in provincial health plans and in Canadians' perceptions of health care. Section 13 of the CHA spells this out by requiring that provincial governments "give recognition" of federal contributions in public documents, advertising, or promotional information. Furthermore, the federal government has taken on the moral authority of protecting equal access to the health-care services that are provided by provincial health plans. As such, the policy legacy of the CHA goes potentially far beyond imposing financial penalties.

On paper, the Canada Health Act's primary emphasis is to establish the standards by which cash contributions from the federal government are transferred to the provinces in order to help fund insured services provided by provincial health-care plans. For a province to receive the full amount it is due, it must satisfy the five basic principles described in sections 8 to 12 (public administration, comprehensiveness, universality, portability, and accessibility). While these broad principles existed in previous medical-insurance legislation, the CHA emphasizes that the "primary objective" of federal involvement is to "facilitate reasonable access to health services without financial or other barriers." In order to do this, the CHA is very specific about the standards to which provinces will be held; namely, no extra-billing and no user fee imposition. As federal transfers have been reduced substantially over the past fifteen years, questions have been raised about the extent to which the federal government can impose such conditions. Nevertheless, today most provinces do not infringe these standards: in the 1996-97 fiscal year, \$2 million of the total cash transfer was "docked" for violations, of which \$1.3 million was attributed to Alberta's allowance of facility fees (Manitoba accounted for \$588,000 in user fee deductions, while the rest was due to much smaller reductions to Nova Scotia and Newfoundland). Since 1995 (the last year British Columbia reported the practice), no province has allowed extra-billing and, since April of 1997, Alberta has stopped charging facility fees as well. From this, one could conclude that, for the time being at least, the federal "carrot and stick" routine still exercises a sufficient deterrent for most provinces.

One could also conclude that, at the end of the day, most provinces, publicly at least, support the *principles* enunciated in the CHA. In British Columbia, for example, the Medicare Protection Act of 1995 repeats the actual wording of the CHA: the preamble includes a commitment to "confirm and entrench universality, comprehensiveness, accessibility, portability and

public administration as the guiding principles of the health-care system of British Columbia" (Statutes of British Columbia, Chap. 52, 44 Eliz. 2: 1). Quebec officials have often repeated that, while they have no problems with the content of the CHA principles, they consider themselves bound by the principles of the Quebec health-care system as stated in the *Loi sur les services de santé et les services sociaux*, not by the Canada Health Act.

Indeed, the major bones of contention between the provinces and the federal government have been process issues. These issues include the way in which the CHA was formulated and implemented, which some provinces such as Alberta and Quebec felt overstepped the bounds of federal jurisdiction. More specifically, at issue has been the process by which the federal government exercises an oversight function on provincial health-care plans and unilaterally enforces the CHA, leading to a "dysfunctional partnership" between the two orders of government (Neumann, 1993).

Existing Processes and Courchene's Framework Axioms

The present system governing the CHA principles has no institutionalized process for consultation or dispute resolution between the federal government and the provinces. The mechanism governing this process works, in theory, in a bilateral fashion but in practice resembles more a unilateral process in which decisions are made by the federal government.

Each province is required to submit an annual report, including a financial statement, that details how its health-care plan conforms to CHA principles. Under section 14 of the CHA, if the federal minister of health decides that a provincial health-care plan has "ceased to satisfy any one of the criteria," he or she is empowered to report to the Cabinet and direct the Finance department to make deductions from transfer payments. The existence of extra-billing is usually obvious, but the user fee question is sometimes less straightforward: in the Alberta case for example, private clinics, not public hospitals, were charging facility fees. The point of contention is about who decides whether such practices constitute an infringement of the CHA principles and by how much in dollar terms. Here, there is not much room for dispute resolution. The minister of health decides and determines the dollar amount. There is a consultation process, but it works in a rather patriarchal fashion: the minister must inform the province of its wrong-doing and allow time for discussion, but the final enforcement decision is his or hers alone. In some cases, provincial governments have conferred with the federal government before implementing certain practices, thus voluntarily modifying them to avoid financial penalties. The bottom line, however, is that regardless of whether there is a dispute or not, the federal minister of health really does now seem to act as judge and jury of the provinces (Ministerial Council on Social Policy Reform and Renewal, 1995: 17).

Such a unilateral process in health care leaves much to be desired in terms of the "framework axioms" of an interprovincial convention. Courchene's

ACCESS model for a socio-economic union stipulates that certain axioms, or underlying principles, should guide all policy areas. The existing CHA principles, for example, are not incompatible with Courchene's axioms of equity, equality, citizen rights, and non-discrimination between provinces. However, the way in which the federal government enforces the CHA is at odds with Courchene's principles of transparency, accountability, federal flexibility, and subsidiarity. The areas of efficiency, provincial flexibility, and asymmetry leave room for debate.

Over fifty intergovernmental health advisory committees already operate at the ministerial, deputy ministerial, and administrative levels, covering everything from population wellness to physician supply. In addition, provincial health ministers meet formally once a year together, and with their federal counterpart, following meetings of their deputy ministers. (Quebec does not always officially attend these meetings or sign the agreements, though representatives of the Quebec government are usually present as observers.)

Despite the existence of numerous intergovernmental committees and the frequency of contact between provincial and federal health policy-makers, the often acrimonious public confrontation between the federal minister of health and provincial officials shows that transparency is a problem. Transparency is also problematic in the present situation because there is no real mechanism for consultation about the funding process. The federal government, through its budget-making authority, unilaterally sets the cash transfer amount to the provinces. Therefore the federal government, even according to the National Forum on Health, "imposes change" on the provinces, making it difficult to manage the financing of health-care services (National Forum on Health, 1997). This process allows one level of government to off-load its deficit problems onto the other (Boothe and Johnson, 1992).

Accountability is also problematic because the fiscal transfer system in place does not isolate responsibility and makes it difficult for voters to "pin blame" on politicians (Richards, 1996). The federal government, which imposes accountability on the provinces, has no *de jure* responsibility in the health-care sector. In the political arena, the spectacle of "blame avoidance" (Weaver, 1986) in which one level of government blames the other for problems in the health-care sector, makes it difficult for voters to exercise their democratic right to take politicians to task for their actions. The problem of accountability is exacerbated by the spectacle of warring factions between governments over the principle of the federal spending power and amounts of federal funding.

Federal flexibility is also problematic since the federal government does not allow the provinces to opt out with compensation from the CHST. In the case of health policy, it is obvious that the federal presence provides invaluable political capital for the federal government. In terms of efficiency and subsidiarity, the present situation does seem to reflect Courchene's principles. Health care can, and is, provided efficiently by the provinces. There

is no need for federal involvement in the actual administration or delivery of services in order to ensure efficiency. Nevertheless, this should be qualified by pointing out that while the process of transfers and enforcement may be contrary to subsidiarity, the principles of the CHA do not necessarily impinge upon the efficiency of provincial health-care systems. According to many comparative analyses by economists and policy analysts, there is evidence that public administration, universality, comprehensiveness, and equal access contribute directly to efficiency (Marmor, 1994; OECD, 1995).

*The Flexibility Issue: The Provincial
Role in Health Care*

Many provincial governments have raised concerns that provincial experimentation in health care not be hampered by federal government interference. Courchene's ACCESS model responds to these concerns by ensuring provincial flexibility that can allow non-discriminatory, *de facto* asymmetries to exist in policy areas. In theory, the CHA principles impinge on flexibility and asymmetry by interfering in an area of provincial jurisdiction – in process terms, by giving the federal government financial instruments to impose and enforce rules on the provinces, and in symbolic terms by holding the provinces to what are in fact federal standards. A brief comparison of provincial health-care systems shows that, in practice, such flexibility and asymmetry already exist, up to a point. The point in question is the yardstick of the CHA principles. Again, publicly at least, no province takes issue with them; what is at issue is the process of their enforcement.

If the CHA principles are not at issue, then one could argue that the present arrangement allows flexibility and relative asymmetry to exist. Indeed, provincial health-care systems developed individually, in response to public demand and political pressure. In hospital insurance some provinces, such as Saskatchewan, had existing plans in place, while others, such as B.C. and Alberta, modified their plans to meet federal cost-sharing agreements. In the case of medical insurance, the public model developed in Saskatchewan was diffused to the other provinces through federal involvement. This gave the provinces leverage over the medical profession and many private insurance interests who hotly contested the public model. The doctors' strike over extra-billing in Ontario is a case in point.

The case of Quebec is an example of asymmetry in that the health-care system developed outside the framework of federal involvement, was part of a broader strategy of integrative social services, and imposed more stringent standards on its health-care providers than did the other provinces. Indeed, after the ban on extra-billing, many provinces, such as Ontario, adopted the Quebec model (which allows physicians who choose to withdraw from the provincial health-care plan to either bill the plan according to the fee schedule or practice entirely on their own).

It is true that the CHA allows for only limited asymmetry, at the margins of the non-profit health-care system. Hospital plans are usually operated by

the provincial ministry of health, while medical plans are often administered under the auspices of a public agency. Insured in-patient and out-patient services tend to be uniform across the provinces, although some variation exists (for example, private nursing care ordered by an attending physician is covered in Alberta but not specified by Ontario and Quebec). Hospitals are generally operated as non-profit institutions financed by global budgets negotiated with provincial governments. Although most hospitals are not directly administered by the provinces, they are dependent on public funds for most of their operating costs (including medical supplies and equipment, and nursing personnel), and therefore subject to public decisions about their operation (either directly by government or through the intermediary of regional boards). In the past five years, bed, laboratory, operating room, and hospital closures have been the principal methods of cost control for hospital administrators and provincial health departments. The result has been longer waiting lists for elective procedures and non-emergency in-patient services and a greater reliance on out-patient care. This is not considered by the federal government to contravene the terms of the CHA, however. In addition, apart from insisting on the removal of facility fees, the federal government has not objected to the use of empty hospital wings or privately built health clinics to dispense non-insured benefits, such as the Health Resource Centre initiative in Calgary (Engelman, 1997). Nor has it made any move to curtail acute-care centres with excess capacity from using public health-care services to treat Americans and other non-Canadians at a hefty profit for provincial coffers. In a recent controversy over the use of facilities at the Institut de cardiologie de Montréal to treat foreign fee-paying patients, it was the Quebec minister of health, Jean Rochon, who raised questions about the possibility that this practice impedes access to services, and not his federal counterpart.

Provincial health plans also cover most "medically necessary" services provided by physicians, although there is some variation in terms of defining non-necessary services. There is also considerable variation in terms of extra services covered by provincial health-care plans: optometric and some chiropractic services are covered in Ontario but not in Quebec, for example. Provinces generally pay physicians through a fee schedule negotiated with provincial medical associations. The amount of these fees and the way they are imposed varies quite a bit, as do practices that regulate physician supply. Quebec, for example, reimburses physicians at a lower rate than most other provinces. In addition, Quebec allows for a different payment system altogether through the staffing of its CLSCs (community health and social services clinics) by salaried physicians. Quebec was also the first province to impose limits on billing, caps on specialist salaries, and differential fees to physicians with new billing numbers on the basis of their practice and residence within the province. Other provinces, such as Ontario, have since followed suit on many of these initiatives, while Alberta and B.C. recently instituted fee schedule rollbacks.

Physicians, once among the most vocal opponents of "socialized medi-

cine," have become stakeholders in provincial health-care systems. The interests of provincial medical associations are twofold. On the one hand, they lobby governments to maintain adequate funding for the public health-care system; on the other, many are pressuring provinces to allow private alternatives or market mechanisms to soak up excess demand and capacity. By the terms of the CHA, provinces limit this "extra-curricular" activity to non-insured services, such as cataract removal or in vitro fertilization, which are expensive but very profitable procedures that are in heavy demand.

Excess demand and capacity, many economists argue, are related to the number of doctors in the health-care system (Brown, 1991). In response to this, several interprovincial agreements on physician supply are already in force; for example, those limiting medical school enrolments and the entry of foreign medical-school graduates into provincial medical-care plans. Portability of hospital benefits is guaranteed through reciprocity agreements which allow for direct payment at the provincial rates where the patient is treated. Medically insured benefits, however, are subject to reciprocity for all provinces except Quebec. Quebecers who need medical services in another province are reimbursed at Quebec rates (except in certain areas along the Ontario border), while non-Quebecers must ask for reimbursement from their own medical plans for services paid for in Quebec. Portability has also become an issue in terms of the mobility of physicians themselves. Three B.C. doctors trained in Ontario challenged the B.C. government's differential fees for new billing numbers on the basis of mobility rights under section 6 of the Canadian Charter of Rights and Freedoms, and in a 1997 judgement the B.C. Supreme Court upheld a lower court ruling that had held in their favour (British Columbia, 1997).

As provincial governments attempt to control deficits through reductions in public spending, provincial health-care systems have come under increasing pressure to reduce costs. Provinces have attempted to do this by controlling the supply of health care (through the closure of hospitals or hospital beds and restrictions on billing numbers or salary caps on doctors, for example) and also by controlling the direct demand from consumers (such as waiting lists for elective surgery or de-insurance of non-medically necessary services). In controlling supply, provinces have not come up against the principles of the Canada Health Act, and virtually every province has closed beds and hospitals over the past five years. Controls on demand, however, are more controversial because they raise the issue of what basket of benefits constitutes "medically necessary" services, to what extent deterrent measures can be used to avoid over-consumption of health care, and whether excess demand could be satisfied through private medicine.

THE INTERIM ACCESS MODEL

From the above description of health-care systems in the provinces, it is clear that there is already substantial decentralization in health-care administration, since provincial governments effectively administer health-care

plans, not the federal government. There exists substantial decentralization in terms of health policy making to the extent that provincial decision-makers allocate health resources, not the federal government. The degree of asymmetry between provincial health plans suggests that provincial flexibility is possible even under current arrangements. And, from the point of view of the federal government at least, subsidiarity already exists in health policy: provinces are responsible for health care, but it is the federal role to ensure such efficiency via a public health-care system.

It is evident, however, that the nature of federal standard-setting and the lack of transparency and accountability leave a lot to be desired in terms of the goals and objectives of the ACCESS model. Decentralization according to Courchene's discussion paper has yet to be realized since provincial health policy-making is still greatly affected by federal decision-making (namely, enforcement of the Canada Health Act and transfer payments through the CHST) that remains beyond provincial influence and control.

There are two paths to further decentralization: either the provinces and the federal government agree to rules of the game that set out each other's responsibilities in terms of standard-setting, rule-enforcement and health-care funding, or the federal government vacates all responsibility for these matters to the provinces. These two paths parallel Courchene's "interim" and "full" ACCESS models: the one suggests that more transparency and accountability are possible within federal-provincial arrangements; the other suggests that interprovincial accords without federal interference would lead to a social union that could better serve the health-care needs of provincial residents.

Courchene's "interim" model for decentralization in health care reflects many of the recommendations of recent provincial ministerial reports for a framework of federal-provincial cooperation. It involves, on the one hand, maintaining the existing five CHA principles and, on the other, committing the federal government to a cash transfer floor and setting up a new federal-provincial monitoring process along with an expert adjudication panel. If this were the endgame, it might be possible to envision such a decentralization. In the case of health policy, however, it would not be quite as straightforward. There are three assumptions about the interim model that are problematic: (a) that provinces share the same commitment to the principles of the CHA as does the federal government; (b) that the federal government is willing to share authority over the CHA; and (c) that a cooperative approach to dispute resolution is possible.

Do Provinces Share a Commitment to the Principles of the CHA?

As was demonstrated earlier, the health-care sector in Canada is substantially decentralized already in that provinces design health-care plans and make the decisions about the allocation of resources, and that limited (some would say "controlled") asymmetry exists even with the CHA in force. It is true that

unilateral federal decisions about the CHA are contrary to the spirit of provincial sovereignty in health care. But, in order for Courchene's interim model to work in the health policy field, there would have to be a firm commitment on the part of all the provinces to the five principles enunciated in the Canada Health Act. Courchene himself admits that this is unlikely since, after all, one of the primary motives for decentralization in health care is to soften the rigidity of the Canada Health Act, a rigidity that prohibits barriers to access and insists on public administration. This reveals that a real commitment to existing CHA principles is perhaps more nebulous than some provincial governments will readily admit. Further decentralization in health policy is not, therefore, just about changing the rules of interpretation but about substantially changing the rules of health care delivery as well.

*Is the Federal Government Willing
to Devolve Authority?*

Courchene's interim model and the various reports premiers have commissioned on social policy all assume that the federal government will be a willing partner in decentralization in the health-care field. There have been indications of a less combative federal attitude than in previous years. For example, at a meeting of federal and provincial ministers in September 1997, the federal government and the provinces (except Quebec) agreed to participate in intergovernmental working groups to "share ideas" about the future of public health care, including the contentious business of interpreting the Canada Health Act. Allan Rock, the federal minister of health, pledged to discuss ways to establish a "process that formalizes and makes more transparent" dispute resolution in health care; in the same breath, however, he insisted that "final interpretation and enforcement" of the Canada Health Act is still the exclusive responsibility of the federal government (Canadian Intergovernmental Conference Secretariat, 1997a). In December 1997, Prime Minister Jean Chrétien and the nine provincial premiers launched efforts to negotiate a formal mechanism of cooperation, a "Framework for Canada's Social Union." Nevertheless, at that meeting, the federal minister of health reiterated that there would be no attempt to "open up the CHA to propose some joint decision-making process" (Wills and Thompson, 1997). In the meantime, the federal government is dedicated to shoring up the federal presence in the health sector. For example, on the recommendation of the National Forum on Health, the federal government pledged \$150 million for a Health Transition Fund in its February 1997 budget. The HTF will allocate funds to the provinces to finance "large-scale pilot projects" for health-care modernization; these include pharmacare and home care, two areas which the federal government has indicated a national approach is required.

Related to this is the question of whether the federal government can be bound to providing adequate cash transfers to the provinces. Courchene raises this question in his ACCESS paper by suggesting that, legally,

"Parliament may not delegate its legislative powers to the provinces" (1996a: 26). Here, one could add a more political question: What could motivate the federal government, in particular its minister of finance, to agree to guarantee a sum of money to the provinces for health care? It seems reasonable to suggest that the "golden rule" of fiscal transfers applies here: the federal government ensures that some amount of gold is transferred to the provinces in order to maintain certain rules in the health-care sector through the Canada Health Act; at the same time, however, the amount of gold cannot easily be fixed by the provinces.

*Can There Be a Cooperative Approach
to Dispute Resolution?*

The mechanisms for federal-provincial cooperation discussed in various ministerial reports all hinge on two features: strengthening dialogue between levels of governments on health-policy issues, and setting up a dispute-resolution process that could include expert adjudication. The first feature seems already underway given the frequency of federal-provincial and interprovincial discussions on social policy in the past few years and the recent joint commitment to negotiating a framework for a social union. Nevertheless, even these initial efforts are limited by two strategic obstacles: the federal government's insistence on retaining control of the Canada Health Act, and the position of successive Quebec governments that the federal spending power (and presence) should be restrained in all social policy areas under provincial jurisdiction.

The issue of shared monitoring and dispute resolution will take more political manoeuvring than simply increasing the flow of information exchanged. Could an expert adjudication panel overcome the obstacles outlined above? If the federal government and provinces seem at odds over the interpretation and funding of the Canada Health Act, could we let experts do the talking instead? Panels of experts frequently materialize in discussions of social policy renewal and it is easy to see why: they seem to provide a convenient resolution, on paper, for thorny problems. The Conference of Provincial/Territorial Ministers of Health, for example, suggest the "joint appointment of an expert advisory panel consisting of respected knowledgeable persons" with the objective of "clarifying ambiguities and disputes" in a more transparent fashion. In the real world of politics, however, expert panels could open up a Pandora's box in discussions of health-care decentralization by widening the scope of conflict to include more actors.

Presumably, the composition of such a panel will be a political decision, so these experts will have to come from a range of backgrounds and be responsible to someone. If the advice dispensed by the panel is not acted upon, then such a process could be accused of being a smokescreen for politicians. If they are to have teeth, then the choice of experts becomes crucial. If providers and consumers of health care are represented on the panel, the dispute resolution process will be open to stakeholders in the health-care

system. If stakeholders are not represented, then both providers and consumers of care may be nonplussed to find such "experts" passing judgement on those on the front lines of the health-care delivery system. The experience of regional health boards may be instructive here, as provinces have devolved some decision-making responsibility about the allocation of funding and services. While this rationalizes the process to some extent, it also leads to passing the burden of accountability from provincial health ministries to local bodies (Hurley et al., 1993).

In summary, while Courchene is correct to suggest that many of the pieces for an interim ACCESS model are in place, it is probably inaccurate to characterize this as easily established "with the stroke of a pen" (Courchene, 1996a: 16). Efforts to build a cooperative framework in social policy may be underway, but the extent to which federal and provincial governments, as well as Quebec, can agree even on the rudimentary ground rules for a Canadian "social union" remains to be seen.

THE FULL ACCESS MODEL

Courchene suggests that some of the pitfalls in the interim model mean that it could only exist as a "temporary status quo," while the only workable solution to ensure a social union is a full model of decentralization. This suggestion can be qualified by pointing out that some of the problems of the interim model outlined above are harbingers of even greater obstacles to the realization of full decentralization in health policy. Changing the rules of health policy-making involves unravelling existing arrangements which are already institutionalized and creating new ones that will set in motion different health reform dynamics.

In the area of health policy, Courchene's full ACCESS model means that provinces would be fully responsible for the design and delivery of their own health services. Essentially, provinces already have such responsibilities, except in terms of the presence of the Canada Health Act and the fiscal uncertainty of federal transfers. The full ACCESS model also envisages a "Convention" on social systems which would mean that provinces would agree to be bound by an enforceable accord to maintain principles and standards. The only such principle specifically mentioned by Courchene is portability of health-care benefits across provinces. The social union proposed by this model, therefore, would replace existing principles of the CHA and presumably lead to greater variation across provincial health-care systems than exists today, involving a much greater degree of asymmetry in publicly insured services and financing mechanisms.

Courchene's full ACCESS model tends to assume that interprovincial arrangements can replace existing arrangements, without analysing the political context in which this would happen. The obstacles facing the attainment and practicability of Courchene's full ACCESS model are substantial: (1) since the model involves basically scrapping the CHA and converting existing federal cash transfers into tax points, the federal government

will have to retire gracefully from the health policy field; (2) since the social union can only work with a convention among its members, the provinces will have to agree on these principles; (3) since standards can only exist if they are enforced, the provinces have to agree to be bound by their peers.

*The Existing Federal Presence in Health Care
(Or, Will the Federal Government Go Quietly
into the Night?)*

Political scientists often refer to "institutional" constraints and opportunities in policy change. That is, existing institutional arrangements often make it difficult to create new ones (see, for example, North, 1990). There are at least two institutional hurdles facing the full ACCESS model: the existing role of the federal government in health policy, and the Canada Health Act as an institution in and of itself.

The historical discussion above revealed that the federal government has occupied a political space in health policy for over forty years. During that time, it built up administrative capacity and expertise in the health sector and reaped considerable political capital through its role in monitoring and helping to finance a widely popular system of health-care delivery throughout Canada. As was pointed out earlier, fiscal pressures have led successive federal governments to attempt to disengage themselves from the financing of provincial health-care plans. They have done so by changing fiscal transfer formulas, in what some observers have characterized as "policy making by stealth" (Gray, 1990). In this way, federal officials have been able to engage in politically astute "blame avoidance" strategies while at the same time enjoying "credit claiming" benefits from their involvement in the health sector. The timing of the Canada Health Act is significant in this respect: after the federal government began to reduce its fiscal contribution after 1977, it needed a legislative measure to preserve a strong presence in health care. The National Forum on Health, while broader in scope, may have served this purpose as well. While the bulk of Health Canada's administrative activities are in the areas of health promotion and regulation, the most significant political rewards derive from its involvement in insured services through the CHA, a relatively small investment of only 23 employees out of 6,400 (Dion, 1997). In addition, it is possible that future fiscal dividends may be directed in part, or rhetorically at least, by the federal government to "buy their way into areas of activity that matter to Canadians," such as health care (Greenspon, 1997).

The Canada Health Act itself represents an institutional constraint because it is, essentially, the institution through which the federal government imposes principles in the field of health policy-making. In other words, through the CHA the federal government has institutionalized its presence in health policy. And, as "policies restructure politics" (Pierson, 1993: 624), so too has the CHA shaped the political playing field in health care by shoring up principles of universality and access in provincial health systems

and by setting the boundaries of subsequent health reform. The existence and impact of the CHA has also led to a situation in which the federal government has become "embedded" in the public mind as the standard-bearer and protector of Canadians' health care, much as the state is embedded in society through its past policy decisions (Cairns, 1986: 57).

The considerable political rewards that the federal government reaps from its presence in health policy mean that the incentives to maintain a presence in the health sector are very high. Nevertheless, some argue that recent federal budget decisions, such as the reduction of fiscal transfers and the advent of the CHST, threaten the federal government's presence in the health sector by undermining its ability to enforce existing standards in the Canada Health Act (Banting, 1995c). In this political context, provinces would be well positioned to push the federal government to relinquish the lucrative political space that it now occupies, and/or to sway public opinion to the view that this role is no longer appropriate. A battle for public opinion would involve either convincing voters that the provinces can maintain the CHA principles without federal tutelage, or that these principles need to be revised altogether.

Is Interprovincial Agreement on Principles Possible? (Or, How Do We Get There from Here?)

This leads to a second issue confronting the full ACCESS model: if existing arrangements are to be replaced by interprovincial accord, this necessarily means replacing federal legislation, the Canada Health Act, with something else. As some of Courchene's critics have pointed out, provinces have not often demonstrated the collective capacity to make decisions on divisive issues (Usher, 1996). Could they do so in such a sensitive area as health policy? There are two scenarios about this.

One scenario is that the CHA principles can be duplicated in a new interprovincial accord on the social union. At first, this might seem plausible because provincial governments are, currently, committed to respecting the Canada Health Act. The hypothetical question, however, is: If the CHA disappeared, would provincial premiers agree upon a similar set of principles to take its place? At the level of political ideas, one could argue that consensus is possible because enough provincial premiers fundamentally agree with existing principles and could build from there. Indeed, if there is a consensus on this, then legislation may be redundant (Osberg, 1996).

Another way of thinking about whether there could be agreement on existing principles comes from the study of international relations. As Keohane (1984) suggests, in the international system a "hegemon" (such as the U.S. in the international political economy or, for our purposes, the federal government) can provide powerful incentives to persuade partners (nation-states or, in this case, provinces) to conform to specific rules that govern an institutional arrangement (such as the doctrine of free trade in the

GATT or, here, the five principles of the Canada Health Act). When the hegemon retreats or ceases to enforce its deterrent powers, the incentives to cooperate among partners may still remain, so that the rules that govern these arrangements tend to stay in place (Axelrod and Keohane, 1985). One could therefore hypothesize that, in the absence of the federal government as a hegemon, an interprovincial accord could still provide a framework for cooperation to preserve the CHA principles. From the experience of international relations, however, it is clear that in order for this to occur there would need to be a strong legal or regulatory framework in place.

This institutional argument suggests that provincial governments would be somehow constrained to inscribe existing principles into a new convention or accord. Past experience in health policy development leads to a certain path that sets the boundaries of future reform. The diffusion of principles about public administration, universality, and access to health care has constrained the scope of political debate about health reform. No provincial premier can run on a platform to dismantle public health insurance. To take a less extreme example, provincial politicians are sometimes obliged to backtrack on proposed cuts to health-care funding.

Courchene also states that one of the reasons provincial premiers would sign on to the same principles is due to moral suasion: no provincial citizenry would accept that its government be in violation of national norms. Norms are standards of behaviour that reflect a certain code of conduct that actors are expected to follow. But in order to be operative, norms have to be imposed in some manner: formally, through a power relationship in which an actor or set of actors can inflict reprisals if these norms are not adhered to; or, more informally, in ways that are not legally binding but which nevertheless suggest sanctions if a certain code of behaviour is not followed (for example, the stigma of being considered a moral outcast). Beyond this definition of norms as standards of behaviour is the idea that some norms can become internalized, that is, taken for granted to such an extent that they become so universally accepted as not to require enforcement agents (Finnemore, 1996).

Achieving consensus on principles through moral suasion requires that all actors recognize these principles as norms. It is difficult to gauge, however, to what extent principles of universality, equal access, and public administration are, in effect, "national norms" to which provincial governments, health-care providers, and even individual citizens would subscribe under different conditions than those in place today. Under the existing legal framework of the Canada Health Act, it is the presence of concrete incentives enforced by a hegemon, rather than norms, that leads to compliance with these principles.

There are other potential scenarios that reflect the difficulty of achieving interprovincial consensus. Whether or not norms exist, cooperation becomes more difficult when power is diffused through decentralization (Biggs, 1996: 43). It is doubtful that political leaders would exert so much effort to change the rules in health policy if the end result is simply to substitute iden-

tical rules. From this perspective, decentralization represents a "means to an end" – something very different than existing principles (Gibbins, 1996: 10). This seems to suggest that the discussion of decentralization is not just about the role of the hegemon but also about the norms it represents. Decentralization has to be considered, in political terms, as an attempt not just to shift standard-setting from one level of government to another, but to change the standards as well.

In this sense, I would argue, we are faced with the potential for a "displacement of conflict" (Schattschneider, 1960), from a confrontation over provincial roles and responsibilities to a confrontation over what provincial health-care systems should look like. The preoccupation with more flexibility in the debate over decentralization should not obscure the fact that the underlying issue is about what this will allow provincial governments to do as they exercise their jurisdictional autonomy. For some observers, "disengagement" of the public sector seems to be the primary motive for change, rather than mere "disentanglement" of governments' roles (Torjman, 1997). Health policy is thus "hostage to a wider political community" in a much larger debate about the role of the state in social and economic life (Deber, 1996: 43).

The displacement of political conflict is usually accelerated by the existence of alternatives and, as policy-makers know, alternatives are essential in the agenda-setting process (Kingdon, 1984). Health care is a public-sector service that, unlike social assistance for example, has readily available and hugely profitable alternatives in the private sector (Neumann, 1993). If CHA-type principles are challenged, the consequence will be to further expose provincial governments to pressure from stakeholders who have an interest in private alternatives for health care.

Many powerful stakeholders see decentralization as a mechanism to allow more flexibility and the entry of alternative market mechanisms into health-care delivery and financing. Private insurers, whose coverage offerings usually begin where public plans leave off, could increase their health-care market share by pressuring provincial governments to reduce publicly insured benefits (Fennell, 1996). Physicians have slightly different interests. On the one hand, the public health-care system has allowed Canadian doctors to retain fee-for-service medicine, a practice increasingly challenged in the U.S. by managed care alternatives. As a founding member of the Health Action Lobby, for example, the Canadian Medical Association has been insistent in its pressure for more stable federal funding of provincial health-care systems (Canada Health Action Lobby, 1995). On the other hand, the CMA has adopted the attitude that, in light of continued cuts to public funding, the principles of the CHA are unsustainable. Thus, more private medicine seems to be the policy of choice among many physicians as a way to deal with excess demand and to guarantee more stable financial remuneration (Gray, 1996).

If confrontation over health care becomes as divisive as the premiers' ini-

tial reaction to Courchene's model suggests, then it may be difficult to envisage shared principles in the health sector, let alone realize a social union. Courchene is probably correct to include only portability of benefits, a lowest common denominator approach, in the full model of the interprovincial accord. But decentralization could lead to a situation in which full-scale asymmetry between provinces makes it difficult even to agree to a portability minimum.

*Can an Interprovincial Agreement Be Enforced?
(Or, How Will the Glue Make the Provinces
Stick?)*

In the real world of politics, there has to exist some agent or mechanism to bind partners together in a collaborative effort. In other words, political power, defined as the capacity of one actor to influence the other (Dahl 1963), has to be exerted to get collaboration. Normally, this power to influence depends on the types of incentives that can persuade an actor to join in a collaborative effort. Rational choice theory insists that the way to achieve collective action is to provide selective benefits to members that adhere to the group. Without such incentives, any member of a partnership can be a "free-rider" if there are no enforceable sanctions for defecting from the rules (Olson, 1965). As both supporters and detractors of national standards have pointed out, there is little incentive for a provincial government to abide by rules if breaking them entails no costs.

What sanctions in health care can be applied to avoid the free-rider problem? At present, the federal government encourages harmonization in provincial health systems through the mechanism of the Canada Health Act, much as an international organization can enforce the rules of the game in the international economy, for example. Enforcement would be the most precarious element of an interprovincial agreement because of the absence of enforcement mechanisms to bind the social union in health policy. Courchene bases his scenario of interprovincial collaboration on enforcement through threats of retaliation and exclusion. In the full ACCESS model, provinces would be bound together on all policy areas; thus the rules that govern health policy would have to be followed or sanctions could be imposed on other sectors. Provinces might, therefore, have an incentive to cooperate on health policy, since economic costs might be imposed in another sector as retaliation. The flipside, that other sectors would see sanctions in health policy as an incentive to play by the rules, is less probable, since it is not clear what sanctions could in effect be imposed on the health sector.

Several lessons from experiences in other settings could be applied to an interprovincial agreement. These enforcement mechanisms include those in place in the European Union, the Agreement on Internal Trade among the provinces, and the existing constitutional framework in Canada. In addition, I will address Courchene's argument about enforcement through moral suasion.

One suggestion about enforcing interprovincial agreements comes from the experience of the European Union. Like European member states, provinces would have "full" sovereignty in health care after decentralization (in accordance with the principle of subsidiarity). It should be remembered, however, that sovereignty in health policy is jealously guarded by European states, and that there are no formal stipulations in the Maastricht Treaty about the provision of health care within and between member states. The practice by which citizens of one European country residing in another member country can enrol in the host country's health-care plan does not entail a harmonization of European health-care systems to the extent that now exists between the Canadian provinces. Indeed, the idea of a social union or European welfare state fell by the wayside in the process of European unification, which was geared towards labour mobility, not social policy harmonization (Streek, 1995). Nevertheless, the health sector is affected by the exigencies of the EU monetary union, which forces member states to cut back on social wages and exerts pressure on public spending in health care.

Another model for enforcement is the interprovincial Agreement on Internal Trade (AIT), which involves a dispute-resolution mechanism in the form of non-binding recommendations from an advisory panel. The basis for enforcement in the AIT is the existence of "mutual self-interest" rather than formal rules (Biggs, 1996). This mutual self-interest is what leads to mutual recognition of the costs involved in defecting from the agreement. Could such a mutual self-interest be a mechanism to bind provinces to standards in health policy?

In the absence of central authority, as Axelrod (1981) suggests, cooperation can emerge between rational egoists if they perceive this kind of mutual self-interest and engage in reciprocity or "tit for tat" behaviour. Adherence to trade agreements is thus based on two perceptions – that the benefit of freer trade is a positive outcome for the economy, and that the externalities associated with non-compliance are too costly. If, for example, a trade dispute escalates, both parties perceive they are liable to lose out and so agree to cooperate or not defect from the agreement. In the international system, the potential of sanctions leads to the necessary concessions that bind partners together in trading regimes. But in health policy, it is not clear that the assumptions underpinning this dynamic would work in the same way. Does the non-respect of rules or conventions by one province – say, the decision to privatize the health-care system in British Columbia – matter to the other provinces? Not really, unless the mobility of residents from other provinces is compromised; this would be the case if enough residents of Alberta fell ill in British Columbia and ran up health-care bills that imposed a cost on Alberta's public treasury. Would it be in the interest of other provinces to impose sanctions because of this? For example, would it matter enough to Quebec that British Columbia had privatized its health-care system to lead that province to agree to sanctions? Even if there was an agreement to sanction the behaviour, would the penalty imposed be suf-

ficient to justify the resources expended or even to ensure that British Columbia would comply?

The only real incentive in the health sector per se would be what Courchene calls "mutual recognition" in the area of mobility rights (that is, portability of benefits) between provinces, but this does not necessarily guarantee the harmonization of health-care systems across the provinces. The existence of a reciprocal medical-billing agreement between nine provinces points to the possibility of agreement in terms of the portability of benefits.

Quebec, however, made the calculation that the benefits of entering the agreement (that is, that Quebecers would not have to pay out of pocket) were not high enough to offset the costs (reimbursing for services at higher host province rates). So if British Columbia decides that privatized health care is the answer to its fiscal crunch, Saskatchewan's only punitive recourse would be to refuse to pay the higher cost of out-of-province medical claims. Or it might try to convince the other provinces to impose sanctions in another sector (since social and economic sectors would be linked in the interprovincial agreement), but there would also have to be incentives for this cooperation to take place.

Could provinces engaged in an interprovincial agreement be bound by existing "treaties," namely the Constitution? The Health Action Lobby, for example, suggested constitutionalizing national standards in the Canadian Charter of Rights and Freedoms as a way of enforcing compliance by provincial governments (Tremayne-Lloyd and Stoltz, 1991). The drawbacks include inviting judicial rigidity into health policy-making, the potential use of the notwithstanding clause, and getting agreement from the provinces to this kind of amendment in the first place, which is highly uncertain. Individuals could, under section 6 of the Charter, raise the issue of mobility rights to ensure portability (Swinton 1995, quoted in Courchene, 1996a: 30). The barriers to this would include the prohibitive expense of such action, unless other actors were involved. One actor that could become involved is the federal government, by taking a leadership role in encouraging compliance to national standards in an interprovincial accord. If the federal government, hypothetically, relinquishes its fiscal authority in health care, it could still exert some kind of moral authority over the provinces through exhortation to convince recalcitrant provinces to abide by the rules, or by mobilizing public opinion to do the same.

Courchene's argument for enforcement of an interprovincial accord also rests on the idea of "moral suasion" – that fears of becoming moral outcasts would make compliance by provincial governments "virtually assured" (Courchene, 1996a: 31). Moral suasion raises the spectre of the symbolic costs of noncompliance: if a province defects from group principles, its residents no longer share the same social rights of citizenship as Canadians in other provinces.

The use of moral suasion is complex because it suggests governments can be bound together on the basis of fear of moral sanctions, a kind of sophis-

ticated version of schoolyard norm imposition. More importantly, the moral suasion argument suggests that the weight of public opinion would provide a strong enough lever to convince potentially recalcitrant provincial governments not to stray from certain principles or standards in reforming health-care systems. Relying on the court of public opinion as an enforcement mechanism, however, is problematic for at least two reasons. First, it is not certain that all Canadians would share a mutual consensus about the principles enunciated in an interprovincial agreement; and second, it is not evident that voters in one province would necessarily be concerned if their health-care system differed from that in another province.

The moral suasion argument depends on an important assumption – that all participants in the health-care system (patients, providers, governments) have internalized and share the same norms. The abundant literature on norms in international relations shows that, while convergence on norms can encourage compliance by setting the boundaries of state action, norms can themselves be constructed by both state and societal actors (Checkel, 1997). These actors can have different rational interests or different ideological positions that would lead them to embrace or construct certain norms. Despite the attachment of Canadians to the values expressed in the Canada Health Act, it is not clear to what extent Canadians agree on how CHA principles should be enforced. Poll data suggest that the importance of these principles has declined somewhat in recent years and that Canadians are supportive of user fees, even though the federal government considers them a violation of the CHA (Peters, 1995: 123).

In addition, as was discussed in an earlier section, different stakeholders in the health-care system may have divergent views about norms and about whether existing rules should be changed. For example, while unionized health-care workers may have an incentive in keeping a well-funded public system in place, fee-for-service doctors and insurance companies may not. These stakeholders are bound together in the present health-care system by incentives (not necessarily shared norms) that are imposed by governments (not moral suasion).

There is no certainty that different governments, with divergent ideological baggage and political priorities based on distinct social and economic conditions, share the same norms about health care or other social policy matters. Nor is there any assurance that provincial governments would consider moral suasion an obstacle to defection from an interprovincial accord if there were no other incentives to cooperate. Concerns about reactions from other governments, or about impediments to full mobility for Quebec residents travelling to other provinces, for example, have not stopped the Quebec government from resisting efforts to harmonize its health-care services. Indeed, should the federal government withdraw the Canada Health Act, it is difficult to imagine why a Quebec government would then agree to cooperate with other provinces in this major policy area that, as the European Union experience has shown, remains one of the most vigorously defended symbols of jurisdictional sovereignty.

CONCLUSION

This paper has argued that the type of social union that Courchene envisages in *A Convention on the Canadian Economic and Social Systems* is unlikely to be realized in the real world of intergovernmental politics. Although provinces might have an incentive to cooperate on matters of health policy if different policy areas were linked in an interprovincial accord, the political obstacles to achieving a consensus on health policy remain substantial. This is because it is unclear that all provincial governments as well as other stakeholders in the policy process would agree on what principles or minimum standards to include in an interprovincial accord (in the absence of the Canada Health Act). In addition, it is uncertain that provinces would be willing to commit to cooperation in a policy sector such as health, where the incentive to retain jurisdictional sovereignty is high, while the economic costs of non-cooperation are low. If the ACCESS model were promoted by the federal government, it might have the leverage (as a hegemon) to link policy areas, including health care. But between provinces, this linkage would be tenuous. Ironically, it may be the case that the ACCESS model could be realized only if health care is excluded from such an agreement.

The bottom line about decentralization in health policy is that provincial governments claim full sovereignty over their health-care systems in order to effect the type of health reforms that they and stakeholders in the health system see fit to undertake. Realistically, principles of health-care delivery and financing can only be confined to the provinces as internal standards of behaviour, not as "national norms." Courchene's idea of a social union cannot overcome a central dilemma: Why would provinces irked at the enforcement of standards imposed by the federal government accept the enforcement of standards imposed by other provinces?

The principles of public administration, universality, comprehensiveness, accessibility, and portability that are now in place could hypothetically survive decentralization. The more realistic scenario is that, in a post-Canada Health Act situation, provinces would adopt some existing principles or inaugurate new ones based on fiscal decisions and the balance of social and political forces in each province. In light of the political situation in many provinces, this could lead to a deepening of asymmetry. A third scenario is that decentralization would unleash market forces that can allow provinces to engage in competition with one another over physician resources or in bidding for private health-care investment. If privatization captures the imagination of policy-makers and their constituents in one province, another province might follow suit in an attempt to reduce public expenditures and remain competitive in the medical marketplace. The policy diffusion that ensues may not necessarily entail a race to the bottom, but it will entail a dismantling of the public health-care system and an increase in the total cost of health care for Canadians. At the end of the day, decentralization may eventually lead to harmonization in provincial health policy, but a harmonization that little resembles the health-care systems now in place.

COMMENTS ON
ANTONIA MAIONI'S PAPER
JOHN RICHARDS

Should Canadians more explicitly designate health care as a matter under provincial jurisdiction, with a much-reduced federal role? Based on her paper, Antonia Maioni's answer is an emphatic "no"; my answer is an equally emphatic "yes."

In this short essay, I begin with a sketch of Courchene's ACCESS models, offer a critique of Maioni's critique of ACCESS, and end with two modest proposals.

TOM COURCHENE'S ACCESS MODELS

Two events in 1995 prompted the nine anglophone provinces to think hard about the Canadian "social union." First were unexpected cuts to intergovernmental transfers contained in the federal budget of that year. The ROC provinces responded by asserting that henceforth they would exercise a greater independence in management of social programs within the provincial domain. They published the *Report to the Premiers*, a document highly critical of Ottawa's fiscal initiatives. The Report called for an end to federal unilateralism with respect to such transfers and a clearer demarcation of exclusive federal and provincial jurisdiction in areas of social policy (Ministerial Council on Social Policy Reform and Renewal, 1995).

The second event was the unexpected – to federalists – strength of the sovereigntists in the Quebec referendum. The Ontario government concluded that preserving the federation required the provinces to take major responsibility for the Canadian social union out of Ottawa's hands. Ontario invited Tom Courchene to write what is, among other things, a major non-constitutional proposal bearing on national unity.

Courchene offered both a moderate and a radical option. In the former (the "interim model"), changes with respect to social policy, including health, are incremental. Ottawa agrees to constrain its use of the spending power and to undertake major social policy initiatives only on the basis of federal-provincial cooperation.

In the latter (the "full model"), the provinces unambiguously take over responsibility for health care. In summary, the full model entails the following with respect to management of social policy:

- full provincial responsibility for design and delivery of health, social services, and education in line with the principles in the *Report to the Premiers*;
- an enforceable interprovincial accord whereby the provinces jointly implement and maintain a framework of principles and standards/equivalencies that will guarantee across Canada rights such as mobility and portability;

- an effective equalization program guaranteeing all provinces the ability to provide reasonably comparable public services at reasonably comparable tax rates;
- beyond equalization, fiscal neutrality obtains;
- conversion of existing federal cash transfers (for example, the CHST) into equalized tax-point transfers (Courchene, 1996a: Table 2).

MAIONI'S CRITIQUE

Maioni provides a good description of the status quo when she insists that there is no national health system. Instead, the provinces and territories have created "twelve different health-care systems" bound together by "federal enforcement" (102). Enforcement takes place via the Canada Health Act. For her, both features – provincial management and federal enforcement of the five CHA principles – are essential.

Given these conclusions, Maioni is predictably dubious of the provinces' collective ability to realize either of Courchene's reform options:

Courchene's idea of a social union cannot overcome a central dilemma: Why would provinces irked at the enforcement of standards imposed by the federal government accept the enforcement of standards imposed by other provinces?

The principles of [the Canada Health Act] could hypothetically survive decentralization. The more realistic scenario is that ... provinces would adopt some existing principles or inaugurate new ones based on fiscal decisions and the balance of social and political forces in each province. In light of the political situation in many provinces, this could lead to a deepening of asymmetry (121).

Maioni puts forward three arguments on behalf of her thesis. I shall unpack each in turn.

Argument 1: Allegedly, provincial governments are not fundamentally committed to maintain universal health insurance

She is sceptical as to the provinces' genuine commitment to the five CHA principles chosen to define the health-insurance system. How valid is this scepticism? Admittedly, there exist examples of provinces' allowing extra-billing and user fees, which are violations of the accessibility principle, and Ottawa has contained such violations via imposition of CHA-based penalties. But these violations have all been minor. The matter of political commitment is ultimately an empirical question. What evidence exists that the provinces want to unravel universal health insurance?

This decade, Ottawa and the provinces have undertaken the largest and most prolonged retrenchment in public sector spending since demobilization

after the Second World War. Were any provincial set of politicians ideologically inclined to dismantle universal health insurance programs, the ominous magnitude of federal-provincial deficits and debt provided the ideal pretext. But provincial governments of all political flavours – from the NDP, through the separatist PQ, and Conservatives – have voiced explicit support for universal health insurance and maintained intact their respective programs. Why? The answer is simple and has very little to do with the CHA. From coast to coast, a large majority of Canadians value these programs and would electorally punish any government that dismantled them.

I share Maioni's conviction that these programs are crucial to a good welfare state. I don't share her conclusion that the CHA is their guarantor. On matters entailing major public spending, the only feasible guarantee is the willingness of the majority to pay the taxes required. If majority opinion ever turned against universal health-insurance programs, the CHA would prove ineffective. It would be amended, repealed, or ignored.

*Argument 2: Federal politicians are
reluctant to devolve*

Maioni's second argument is that federal politicians want to be perceived as intimately involved in provision of health services, and accordingly are unwilling to devolve. She is undoubtedly right about their resistance to devolution, but this is a different kind of argument from the first. The former is a normative one, to the effect that good health programs require a federal enforcement role. Here, she is arguing for a federal role because federal politicians want it.

What is missing here is precisely the normative emphasis that motivated the first. Universal health-insurance programs accomplish a number of things that most of us value highly. Let me summarize. Since they are funded by general revenue and not actuarially fair revenues, they redistribute towards those who are poor and who suffer serious illness. Furthermore, public-health administrators have demonstrated across OECD countries their ability to overcome a number of serious inefficiencies associated with private health markets. Finally, universal health insurance programs are perceived as a "merit good" by the majority of Canadians. The majority are prepared to intervene in one another's lives to the extent of insisting that all of us – regardless of individual preferences – pay the requisite taxes to become insured against serious illness.

If the only goal of social policy is redistribution from rich to poor, decentralization poses disadvantages. Centralized policy can assure a uniform pattern of redistribution across the country. It can impose uniform tax and benefit rules that avoid inefficient migration of people out of high-tax regions and into high-benefit regions. But many social programs – health programs par excellence – do much more than redistribute. They realize their potential only if elected politicians and senior managers actually under-

take processes of creative destruction to adapt social programs to changing conditions and new knowledge.

Realizing the efficiency gains of universal health programs requires that politicians and managers behave like business entrepreneurs. They must engage in an ongoing exercise of providing operating income for major health facilities (at a level that is invariably less than that requested), of investing in new programs and new facilities (while scrapping old programs and closing other facilities), and of negotiating income for health providers (which implies representing taxpayers in a collective-bargaining process with unions and professional associations representing care providers). This exercise generates some poor decisions; inevitably, it frustrates certain interest-group expectations. But, overall, it has produced a good set of health outcomes.

The potential benefits of decentralization should be considered both in terms of long-run innovation and short-term efficiencies. The long-run benefit is to increase experimentation by enabling innovation in one province independent of the preferences of voters elsewhere. Voters favour some innovations, which, with a lag, are copied in other provinces. Other provincial innovations fail the test of popular support and are dropped.

The short-run benefits can be summarized under three headings:

- *Reducing managerial scope.* Health is the most important spending ministry in all provincial governments. Were there a single national health program run out of Ottawa, it would be larger, in terms of annual expenditures, than any publicly traded private company in the country. However well intentioned, managers at the centre face more difficulty in assembling relevant information than their provincial equivalents, each responsible for a much smaller domain.
- *Containing interest groups.* Most health programs are local insofar as the benefits accrue to residents within the relevant province. With federal-provincial cost sharing, provincial interest groups indiscriminately promote particular programs based on expected local benefits, expecting that much of the cost can be shifted to Ottawa. This dynamic encourages inefficiency. Effective decentralization requires that provincial citizens choose their health programs via provincial elections and, what is equally crucial, pay for them through own-source taxation. Thereby, provincial citizens have an appropriate set of incentives for a rational discussion of costs and benefits.
- Lowering the cost to people of indicating what they want in terms of services. Assembling and distributing information on policy options and determining public preferences over feasible options is a complex social process – and the larger the jurisdiction, the more complex and more inaccurate. People usually have more accurate analyses and more precise policy preferences about matters “closer to home” than about matters far away. Decentralization can be seen, accordingly, as a means of lowering the information requirements surrounding democratic decision-making.

These ideas lead to a simple but powerful insight into public policy: decentralization encourages a more efficient use of scarce resources because it encourages innovation, lowers information costs required of managers, constrains the ability of interest groups to shift costs, and abets democratic decision-making.

The appropriate institutional environment to assure the viability of health programs is that the provincial politicians making the key decisions be required to raise the requisite revenue from own-source taxation, and that Canadians in their capacity as residents of their respective provinces hold their provincial politicians accountable through general elections. So long as Canada remains a federation and not a unitary state, Canadians should not expect one level of government to fund the programs of another level or to assure the quality of decisions made by another level.

I make an exception to this conclusion in the case of equalization. While it has some perverse effects in lowering accountability, these are more than offset by enabling stability of revenue to provinces delivering major social programs. An important social program for the central government in a federation is to assure "have-not" provinces a fiscal capacity close to the national average. (On the other hand, the clear implication here is that the CHST should be phased out.)

To date, the CHA has served primarily as a general statement of policy goals shared by most Canadians. Precisely because the yoke it imposes on the provinces has been light, the CHA has not impeded them in making controversial health policy decisions over what services to insure, what facilities to keep open, and so on. To date its impact has been arguably benign, but the CHA embodies "unhealthy" political incentives. As Maioni points out, politicians always want to associate themselves with popular programs, and the CHA provides federal politicians with a pretext to don white hats in any medicare parade.

By contrast, their provincial counterparts will always be seen as wearing grey hats. The reason that provincial hats are grey usually has nothing to do with a lack of commitment to universal health insurance. The reason lies elsewhere: it is impossible to run a provincial health system for any length of time without getting a little political mud on your hat.

Argument 3: The provinces allegedly cannot sustain a cooperative approach to dispute resolution, over health or other aspects of social policy.

Here, I am inclined to agree with Maioni. The provinces may agree to a modest agenda of interprovincial cooperation and hopefully can oblige federal politicians to accept a limit to the federal spending power in matters of exclusive provincial jurisdiction. Beyond that I have low expectations.

But so what? Does it significantly harm social policy if intergovernmental coordinating institutions are weak? To take a limiting case, assume Quebec

secedes from Canada, in which case all social policy coordination between ROC and Quebec ceases. Transitional political conflict may well harm social policy on both sides but, thereafter, I expect Quebec and ROC would continue to pursue social policies reflecting the majority preferences of their citizens – and the result would be little different from what prevails now.

Admittedly, practical health policy problems have frequently prompted the provinces and Ottawa to collaborate via ad hoc intergovernmental arrangements. Maioni refers to there currently being over fifty intergovernmental health advisory committees. What is key is that these arrangements are ad hoc, and seen by all concerned to be mutually advantageous. Provided the federal role is to facilitate such arrangements and not to enforce, it is a useful one. It does not dilute accountability of provincial governments to their respective provincial electorates.

In this discussion, we must keep clear the distinction between securing the economic union and what is, by analogy, often termed “securing the social union.” The essence of an economic union is establishing uniform rules over a market regulated by multiple governments. However, governments’ managing health and other social programs is not primarily a matter of setting rules, but is more akin to running a province-wide corporation. In general, forcing intergovernmental social policy coordination is an exercise in alchemy – doomed to failure.

Attempting to build national social policy standards from the bottom up, as envisaged in Courchene’s full model, is sometimes justified by reference to the attempts by members of the European Union to create a workable social charter. While the economic advantages from the European common market are undeniable, the benefits of a social charter remain nebulous. It may impose some very wide margins within which member states operate their respective social policy regimes, but it will almost certainly remain, like the CHA, a statement of goals that provides only a vague constraint on the actual policies pursued by member states.

CONCLUSION: TWO MODEST PROPOSALS

For anyone who takes seriously the arguments in favour of decentralization, it is vital that the provinces maintain a common front – at least to the extent of realizing Courchene’s interim model. Its key ingredient is an effective constraint on Ottawa’s spending in areas of provincial jurisdiction. Without such a constraint, democratic accountability will forever remain a confused exercise in federal-provincial recrimination.

Beyond that general proposal for the conduct of social policy, I put forward two modest health policy reforms: investment in a nation-wide health information system and “federalization” of the Canada Health Act.

Information is, in the jargon of economics, a “public good,” one that private markets and local political institutions almost always undersupply. Ottawa could exercise a greater influence on the quality of provincial health programs if it abandoned its paternal instincts to chaperone the provinces via

the CHA and fiscal incentives. Instead, Ottawa could invest heavily in the complex task of providing high-quality, easily accessible information. Performing this task well is crucial if provincial decision-makers are to make wise decisions and if electorates are to hold their respective governments accountable for health policy outcomes.

Undertaking this task was one of the central recommendations from the recent report of the National Forum on Health. To give a feel for what is entailed, I quote:

A nation-wide health information system should be capable of operating at both the provincial/territorial and national levels ... For success, three key ingredients must be present:

- Enhancement of public accountability. This requires accumulation of information about population health, the medical and non-medical determinants of health, and the effectiveness of health policy interventions.
- Multi-layered high-quality content for all decision makers at all levels. This calls for ongoing research and evaluation of existing information and identification of information gaps. Emphasis must be placed on women's health issues, gender-based research, Aboriginal health issues, alternative and complementary interventions, and non-medical determinants of health.
- Strategies for dissemination and uptake of information by decision makers. Financial and other incentives as well as automated and non-automated information tools are needed. Value-added benefits of using such incentives and tools must be clearly demonstrated to decision makers (Canada, National Forum on Health, 1997b: 35-36).

My second proposal is to federalize the Canada Health Act. A potential compromise on the CHA is to leave it in place as a general guideline for programs that Canadians value highly but, henceforth, to entrust its enforcement to Ottawa *plus* a consensus among the provinces.

How should provincial consensus be defined? Unanimity is nonsensical: the putative provincial offender could veto any proposed sanction. Since patriation of the constitution in 1982, the default formula to define consensus has been the "7/50" rule: two-thirds of the provinces representing at least half the Canadian population. A province could be penalized under the CHA, therefore, if agreement to do so exists among Ottawa *plus* sufficient provinces to satisfy the "7/50" rule.

The PIT and the Pendulum: Reflections on Ontario's Proposal to Mount Its Own Personal Income Tax System

THOMAS J. COURCHENE

1. INTRODUCTION

The purpose of this paper is, in turn, to document Ontario's concerns with the current PIT system, to elaborate on the key features of the PIT status quo, to focus on the pros and cons of a separate Ontario PIT, to present a range of federal alternatives to the status quo (and in particular to focus on the possibility of converting the current system to one where the provinces can have tax rate and bracket flexibility) and, finally, to render an assessment of the Ontario proposal. As luck or circumstances would have it, between the conference version of this paper (October 1997) and the final draft, the federal government did alter the PIT system in directions which give the provinces much greater rate and bracket freedom. Nonetheless, except for the post-script, the paper remains largely as originally cast. However, Ontario's decision with respect to mounting its own PIT is now a much more difficult one, since the status quo is far more appealing. Moreover, the ensuing analysis might be viewed as taking on an added dimension, namely documenting the range of pressures which led Ottawa to this most significant shift in the operations of the shared PIT system. The remainder of this introduction presents some historical perspective on the issue as well as the details of the Ontario proposal.

The PIT Swings Like a Pendulum Do

This is not the first time that Ontario has proposed to follow Quebec's lead and to go it alone on the PIT front. Indeed, in the years prior to Confederation (in 1851, to be precise), several Ontario municipalities began collecting personal income taxes. Post-Confederation, British Columbia (1876), Prince Edward Island (1894), Manitoba (1923), and Saskatchewan and Alberta (1932) also entered the field. Ottawa's initial PIT foray occurred

in 1917. In the revenue-strapped 1930s all governments intensified their PIT activities. Of special interest, for the purposes of this paper, is Ontario Premier Mitch Hepburn's 1936 decision to replace the municipal PITs with a province-wide PIT system, in order to replace "the disgraceful checkerboard system of municipal income tax, full of inequalities, anomalies and hardships." However, the province immediately concluded an agreement with the federal government whereby the Department of National Revenue would collect and administer the tax. In the event, this initiative was not an "Ontario-run" PIT.

With the Wartime Tax Agreements (1942-47), all provinces agreed to "rent" the personal income tax field to the federal government, an arrangement which, via several extensions, lasted through to the 1957 Tax Sharing Arrangements. During this period - in 1950 to be exact - Ontario announced a 5 percent personal income tax. However, the federal government refused to collect the tax for the province, and Ontario was reluctant to put its own tax collection machinery in place, so the proposed Ontario PIT simply languished.

The third attempt to embark on a separate Ontario PIT occurred in 1969 when Treasurer McNaughton notified Ottawa that the province intended to implement a separate PIT within two years. By this time, the current Tax Collection Agreements were already in place (1962), the Province of Quebec had established its own PIT (1954), and Ontario (along with Quebec) had separate corporate income tax systems (1957 for Ontario). The background to McNaughton's concern was that, in the light of federal PIT reform following the 1966 *Report of the Royal Commission on Taxation* (the Carter Commission), Ontario wanted some meaningful input into the overall PIT reform process. Presumably in part because of Ontario's pressure, Ottawa agreed to build more flexibility into the shared PIT system, one result of which was that in 1972 Ontario introduced the first of what would eventually be a veritable flood of provincial tax credits. The key point here is that this flexibility apparently satisfied the province and it withdrew its proposal to establish its own PIT.

In 1982, Ontario Treasurer Frank Miller directed the then Ontario Economic Council (OEC) to address the following reference: "What would be the economic implications if the Province of Ontario were to withdraw from the present Tax Collection Agreements with the federal government and institute its own personal income tax collection system?" The triggering factor here was Finance Minister Allan MacEachen's 1981 budget which, in the Treasurer's view, would have had deleterious implications for the Province of Ontario. In response to this reference, the Ontario Economic Council undertook a comprehensive three-volume analysis of the implications of a separate Ontario PIT (Hartle, 1983; Conklin, 1984; Ontario Economic Council, 1983). Aspects of this OEC position paper will be detailed as appropriate in later sections of this paper. For the present purposes, the relevant point is that Ottawa backed off many of the "offensive" (and retroactive) provisions of the MacEachen budget, with the result that

Ontario's PIT proposal once again languished.

This brings us back to Finance Minister Ernie Eves's PIT proposal in the 1997 Ontario budget. Given that this is at least the fourth time¹ since 1950 that Ontario has floated the PIT proposal, "The PIT and the Pendulum" title seems particularly apt, with obvious apologies to Edgar Allan Poe.²

The 1997 Ontario PIT Proposal

From the 1997 Ontario Budget (Budget Papers: 82):

Changes that Ontario has proposed to its income tax that reflect reasonable and legitimate Provincial objectives have been rejected by the federal government. In a little more than a year, the federal government has refused [under the Tax Collection Agreements] to administer:

- A Fair Share Health Care Levy, like the one proposed in the Common Sense Revolution, on the income earned by high income people. Instead, Ontario has had to resort to the more complicated surtax approach, with different results than the Government had originally proposed;
- A simple check off box on Page 4 of the income tax return that would easily allow taxpayers to donate tax refunds to reduce the debt of the Province; and
- A tax credit to ensure that taxpayers making donations of their current income or more to Crown foundations could get full tax relief in the year in which they made the donation.

These examples do not define an income tax system that reflects the needs of Ontario today ... In saying "no" to the policies noted above, the federal government is, in effect, defining what it thinks is in Ontario's interest.

One response to this would be that these are rather weak reeds to bring into question the entire Tax Collection Agreements (TCA), whereby Ottawa collects Ontario taxes free of charge, allows the province to mount surtaxes, low-income reductions, and a range of tax credits which Ottawa administers for a small fee, and minimizes tax compliance costs on the part of Ontarians since there is only one tax form to fill out. The problem with this response is that these personal income tax agreements are part and parcel of the much larger Ontario-Ottawa tug-of-war across a wide range of policy fronts. And some of Ontario's claims for fair and equitable treatment in areas like Employment Insurance, training devolution, and GST harmonization also carry over to the Tax Collection Agreements. With respect to the first of the above bullets relating to the Fair Share Health Care Levy, what is the rationale for Ottawa to say "no" to Ontario's desire to apply this levy to taxable income when Ottawa allows Manitoba, Saskatchewan, and Alberta to levy "flat taxes" on taxable income? There is none.

The 1997 Ontario budget does not stop here. It adds two further rationales, the first of which is (Budget Papers: 83):

There are also costs to Ontario taxpayers from participating in the tax collection agreement. For example, the federal government collects over \$1.5 billion in Ontario income tax before remitting any of it to Ontario. This delay results in higher interest costs to the Province, which must be paid for by Ontario taxpayers. The federal government also retains fines, interest and penalties collected on Ontario tax owing. Ontario taxpayers should not have to bear these costs, which we believe are over \$100 million per year.

The second concern is more telling (*Budget Papers*: 83):

The current Tax Collection Agreement also makes Ontario vulnerable to federal base changes which automatically affect Ontario's revenues. The terms of the current agreement leave the Provinces no choice but to automatically adopt most federal income tax changes, including those that the Province does not support.

The conversion of the Old Age Pension into a "super GIS" is an excellent example of this last point, since the tax-revenue losses to Ontario will be substantial, as will be demonstrated later.

With this as prelude, Eves then unloaded a ticking timebomb on the system:

Unless the federal government is prepared to address these inequities, Ontario will have to seriously consider withdrawing from the current arrangement. We have already begun to seek expert advice on this matter to protect Ontario taxpayers' best interest (Ontario Budget Speech: 35).

The Budget Papers (83) elaborates further:

Ontario will be examining alternatives to the current Tax Collection Agreement in the coming months. Expert advice will be sought from the private sector on how Ontario could collect its own tax efficiently and at lower cost. It is not clear to Ontario that the current federal approach to defining the tax base and to collecting the resulting tax is the most effective and least costly alternative. The Government believes that the private sector will have a number of useful suggestions for, and a role to play in, structuring and collecting an Ontario income tax.

Were Ontario to leave the Tax Collection Agreement and, like Quebec, adopt its own personal income tax system, the implications for the federation would likely be enormous. Among other things, it would almost certainly lead to similar initiatives in the West, perhaps on a multi-province basis. Beyond this, the federal government would lose control over the overall progressivity of personal income taxation, since Ontario would be free to design its own rate and bracket structure. More problematic still, the possibility would exist for different definitions of income – Ontario could, for example, have its own definition of what constituted "capital gains" for

income tax purposes. And Ontario would no longer be bound by the existing TCA provisions that prevent provinces from mounting PIT surtaxes or credits that would impede the operations of the internal economic union.

Is this mere rhetoric? Does it just represent the latest round of leverage being brought to bear on Ottawa to alter its errant ways in terms of the treatment of Ontario in the federation? We do not know the full answers to these queries. However, the fact that this appears not in some mimeographed speech to a local Chamber of Commerce but rather in the official fiscal blueprint of the Province of Ontario suggests that the proposal goes well beyond the rhetorical level. Because of this and because the implications for the federation of a separate Ontario PIT are so dramatic, the issue merits further analysis which, as noted, is the rationale for the present study.

Outline of the Study

Section 2 focuses on the existing Tax Collection Agreements, dealing in turn with a conceptual approach to the operations of the shared PIT, with the criteria for (and proliferation of) provincial tax credits, and with a brief discussion of the "tax on tax" versus "tax on base."

Section 3 then reproduces the main findings of the OEC 1983 position paper, including the benefits and the costs of a separate Ontario PIT and the range of possible alternatives between the status quo at one extreme and a separate PIT at the other. To anticipate the OEC conclusions, their view was that, in the context of the early 1980s, there were alternatives that were preferable to mounting a separate Ontario PIT.

However, much has changed between 1983 and 1997. Accordingly, Section 4 – "Are There New Rationales for an Ontario PIT?" – updates aspects of the OEC analysis by focusing in turn on the stabilization, distribution, and allocation rationales for an Ontario PIT. Again in an anticipatory vein, the implication of the analysis is that the case for an Ontario-run PIT is considerably stronger in 1997 than it was in 1983. To this point, the potential case for Ontario going it alone on the PIT front is couched largely in terms of the parameters of the TCA. Are there other, more general, rationales for a separate PIT? We address this in Section 5, "An Ontario PIT as Bargaining Strategy," where the analysis inevitably moves into the speculative realm.

In Section 6, we shift gears, as it were, and assume that an Ontario PIT is a *fait accompli*. What are the likely implications for Ontario, for the other provinces, and for the federation?

All of the above analysis is conducted from an Ontario perspective. In Section 7, we direct attention to the federal government's response to all of this, including both the administrative response (the proposed arm's length tax collection agency, the Canada Customs and Revenue Agency), and the policy response. In terms of the latter, it would appear that the federal government is about to become much more flexible with respect to the operations of the TCA.

By way of a conclusion, we detail an appealing compromise option that appears to be in the offing. This compromise option would very likely have had unanimous support in 1983 and perhaps even in 1990 as well. Indeed, it still might be the appropriate catalyst in terms of preserving the Tax Collection Agreements. As already alluded to, in December of 1997 the federal government did move to implement much of this option, including the announcement of a tax-on-base approach to the shared PIT. Nonetheless, at the time of the final draft (January 1998) Ontario has still not indicated which way it is leaning on this issue. Hence, the analysis ends on a speculative note: Is this another case of the proverbial "too little, too late?"

2. THE OPERATIONS OF THE SHARED PIT

A Schematic Approach

Table 1 presents a schematic approach to the exercise that citizens go through when filling out their annual income tax forms. As is clear from line 1 of the table, the federal government controls the definitions to be used for various income sources. Ottawa also controls the definitions of the deductions from "total income" (row 2). The result is "taxable income." Analytically, deductions are equivalent to non-refundable tax credits (defined in row 4) at the individual's *marginal* tax rate. To see this, note that pension contributions for Registered Retirement Pension Plans (RRSPs) and Registered Pension Plans (RPPs) are deductible from income whereas Canada Pension Plan and Quebec Pension Plan (CPP/QPP) contributions are treated as non-refundable tax credits at the lowest (17 percent) federal marginal rate (see row 4). For those individuals whose marginal federal tax rate is 17 percent, there is no difference between these two types of pension contributions. However, for high-income Canadians, RRSPs and RPPs are in effect treated as tax credits at the top marginal rate (29 percent), while CPP contributions are treated as tax credits at the 17 percent marginal rate. Ottawa decides which income offsets are eligible for deduction (that is, which are creditable at the marginal tax rate) and which are treated as credits at the 17 percent federal tax rate.

Row 3 generates what might be termed "gross" federal tax. This results from the application of the federal rate and bracket structure to taxable income (17 percent for levels of taxable income up to \$29,590, 26 percent for taxable income between \$29,590 and \$59,180, and 29 percent for any taxable income above \$59,180). From this "gross" tax, one then deducts the value of the non-refundable tax credits. These include the personal credit, spousal credit, age credit, CPP/QPP premiums, Employment Insurance (EI) premiums, tuition fees, and the like. As noted earlier in connection with the CPP-RRSP/RPP discussion, all of these non-refundable credits are assessed at the lowest federal tax rate (17 percent). Subtracting row 4 from row 3 yields "basic federal tax."

Thus far, all definitions and parameters are determined by Ottawa. It is

Table 1
A Schematic Approach to the Shared PIT
(Ontario)

<i>Conceptual Step</i>	<i>Elaboration</i>	<i>Jurisdiction</i>
1. Definition of income	e.g., employment income, capital gains, investment income, etc.	federal
equals "total income"		
less:		
2. Deductions	e.g., pension contributions (except CPP) union dues, alimony, capital losses	federal
equals "taxable income"		
apply:		
3. Federal rate and bracket structure	three tax rates 17%, 26% and 29%	federal
less		
4. Non-refundable credits	e.g., personal, spousal, CPP, tuition fees, all at the 17% rate	federal
equals "basic federal tax"		
apply:		
5. Provincial tax rate to basic federal tax	(56% for 1996, 49% for 1997, 45.5% on January 1, 1998, etc.)	provincial
equals "basic provincial tax"		
6. Total federal tax owing	basic federal tax plus federal surtaxes and credits	federal
7. Total province tax owing	basic provincial tax plus Fair Share Health Care levy and surtaxes, reductions, and credits	provincial/ federal
8. Total tax owing	6 plus 7	federal/ provincial

at this point that the provinces enter the picture. Under the shared PIT provisions, the provinces can levy a *single* rate of tax against "basic federal tax" to generate what Table 1 refers to as "basic provincial tax." This rate can be expressed as any multiple of 0.5, i.e., 56 percent for Ontario in 1996, 49 percent for Ontario in 1997, falling to 45 percent for Ontario on January 1, 1998, and 45.5 percent and 58.5 percent for Alberta and Nova Scotia respectively (see column 5 of Table 2).

Total federal tax owing is the sum of "basic federal tax" in row 4 plus or minus the value of federal surtaxes and credits. Total provincial taxes payable are likewise the sum of basic provincial taxes and the net value of the sum of surtaxes, low-income reductions, and the various tax credits (row 6). For Ontario, the surtax is the Fair Share Health Care Levy. For 1996, this was calculated as 20 percent of the excess of basic Ontario tax (the row 5 value for Ontario) over \$5,310 *plus* 13 percent on the excess of basic Ontario tax in excess of \$7,635. The Ontario tax form includes a low-income reduction as well as several tax credits.³

Total taxes owing are the sum of rows 6 and 7, and the tax filer sends a single cheque to Ottawa for this total.

Two further comments are in order. First, this is at the same time a decentralized yet harmonized system for PIT. In terms of the former, with a 50 percent tax rate, for example, basic provincial tax will be one-half of basic federal tax, or one-third of the total taxes paid. In terms of the latter, the system is highly harmonized since the tax compliance associated with delivering, say, one-third of total income taxes to the provinces is quite minimal – two or three calculations to generate basic provincial tax (including the Fair Share Health Care Levy). More effort is needed to arrive at the value of the low-income tax reduction and the various credits, but filers are not likely to complain because these *reduce* their taxes owing. However, the implication of all of this is that Ottawa controls the basic parameters of the system, including the overall progressivity. For example, with a 50 percent provincial tax rate, the overall (federal and provincial) marginal tax rates equal 25.5 percent, 39 percent, and 43.5 percent – i.e., 150 percent of the 17 percent, 26 percent, and 29 percent federal marginal rates. Under the provisions of the tax collection agreements, Ottawa collects the "basic provincial tax" *free of charge*, although it does charge a fee for administering the tax credits (see later).

The final comment relates to Quebec. This province has its own PIT for the Quebec portion of income taxes, complete with its own collection agency. This means that, for Quebec's taxation share, the province has full control over the parameters in Table 1 – the definitions of income, the nature of deductions and credits, the rate and bracket structure, and so on. As a result, however, Quebecers have to file two separate tax forms. There is a further important difference. Because of an agreement in the 1960s (which the other provinces declined), Quebec receives an additional 16.5 personal income tax points. (A PIT point is equal to 1 percent of basic federal tax.) Quebecers still pay federal taxes at the 17 percent, 26 percent, and 29 per-

cent tax rates, but then 16.5 tax points (i.e., 16.5 percent of basic federal tax) are "abated" to Quebec. In effect, then, the effective federal marginal tax rates for Quebecers are 83.5 percent of the 17 percent, 26 percent and 29 percent federal rates, respectively. This does not result in special treatment for Quebec in terms of overall federal-provincial transfers, since the value of this abatement is *deducted* from other transfer monies owing to the province.

As an important aside, the Ontario proposal for a separate PIT would effectively mean that the province would imitate the Quebec regime. One can be pretty sure that Ontario would also (belatedly) pressure Ottawa for additional 16.5 PIT points. But one can be equally sure that Ottawa will not be very responsive to this request.

The Mushrooming of Tax Credits

As noted in the introduction, the Ontario threat in 1969 to mount its own PIT led to increased flexibility in terms of the operations of the shared PIT. In particular, Ottawa allowed the provinces to mount a series of tax credits which the federal government would administer for a fee. Specifically, this administration fee is 1 percent of the credits or rebates for first \$50 per capita, two-thirds of 1 percent for next \$25 per capita, and one-third of 1 percent for the next \$25 per capita. No additional administrative fees are assessed for the credits or rebates beyond \$100 per capita. Note that this \$100 per capita applies to the *sum* of any province's tax credits, not to each of them. No surprise, then, that tax credits have mushroomed.

However, Ottawa has laid down some criteria that must be satisfied before these tax credits will be administered. Essentially, three criteria (generally referred to as the "MacEachen guidelines") apply:

- *Administrative feasibility* – the tax measure must be capable of being administered in an effective manner in order to preserve the efficiency and credibility of the system;
- *Common tax base* – the tax measure must respect the common tax base by not changing the federally-defined personal and corporate income tax bases; and
- *Respect the efficient functioning of the Canadian economic union* – the tax measure must not impede the free flow of capital, goods, services, and labour within Canada.

Ottawa has not always adhered to its own guidelines in terms of administering provincial tax credits, nor has it been even-handed in what it allows different provinces to implement. As Boothe and Snodden (1994) and, before them, Courchene and Stewart (1991) point out, some provincial tax credits, such as the "strategic development" credits in the 1980s and the stock savings plan credits, do inhibit factor mobility. And the "flat taxes" (defined below) that exist in the three prairie provinces were not allowed to be replicated by other provinces.

Table 2
Tax Credits, Deductions, Surtaxes and Flat Taxes, Administered Under the Tax Collection Agreements (1997)

Province	Tax Credits (1995) (1)	Low Income Tax Reduction (2)	Surtax (3)	Flat Tax (4)	Tax Rate % of Basic Federal Tax (5)	Average Tax Rate** (6)	Average Tax Rate*** (7)	Share of Basic Federal Tax** (%) (8)
NEWFOUNDLAND	- Political Contribution - Stock Savings Plan - Venture Capital	No	No	No	69.0	69.5	69.5	1.24
PRINCE EDWARD ISLAND	- Political Contribution - L-S Investment*	No	Yes	No	59.5	59.7	58.9	0.31
NOVA SCOTIA	- Political Contribution - Stock Savings Plan - Home Ownership - Co-op Trust - Employee Share Ownership - L-S Venture Capital - Equity Tax Credit	No	Yes	No	58.5	57.5	57.2	2.41
NEW BRUNSWICK	- Political Contribution - L-S Venture Capital - Stock Savings	No	Yes	No	63.0	61.4	61.1	1.86
ONTARIO	- Political Contribution - Property and Sales - Home Ownership Savings Plan - Employee Ownership - L-S Investment	Yes	Yes*	No	49.0	52.4	48.9	42.91

Table 2 continued

Province	Tax Credits (1995) (1)	Low Income Tax Reduction (2)	Surtax (3)	Flat Tax (4)	Tax Rate % of Basic Federal Tax (5)	Average Tax Rate** (6)	Average Tax Rate*** (7)	Share of Basic Federal Tax** (%) (8)
MANITOBA	Political Contribution - Cost of Living - Property - Manufacturing Investment - Employee Ownership - Royalty Tax Rebate	Yes	Yes	Yes	52.0	64.2	58.4	3.16
SASKATCHEWAN	- Family Tax Credit - Venture Capital - L-S Investment - Stock Savings - Livestock Investment - Livestock Facilities - Royalty Tax Rebate	Yes	Yes	Yes	50.0	68.2	67.7	2.56
ALBERTA	- Political Contribution - Stock Savings - Recovery of Stock Savings - Renters Assistance - Royalty Tax Rebate - Royalty Tax Credit	Yes	Yes	Yes	45.5	48.6	48.5	10.02

Table 2 continued

Province	Tax Credits (1995) (1)	Low Income Tax Reduction (2)	Surtax (3)	Flat Tax (4)	Tax Rate % of Basic Federal Tax (5)	Average Tax Rate** (6)	Average Tax Rate*** (7)	Share of Basic Federal Tax** (%) (8)
BRITISH COLUMBIA	- Political Contribution - Equity (Venture) Capital - Renters Tax - Spousal Transfer Renters - Employee Share Ownership - Employee Venture Capital - Refundable Sales - Mining Reclamation - Royalty Tax Rebate	No	Yes	No	51.0	55.3	54.5	13.80

* L-S is Labour-Sponsored.

** This is calculated as the ratio of the net revenues from columns 5, 4, 3 and 2 to basic federal tax (estimates for 1997). It excludes the tax credits in column 1.

*** This is the column 6 rate adjusted for the impact of the Column 1 tax credits. These credits relate to the 1995 calendar year, so this column is an approximation of the average net tax for 1997.

+ Ontario's surtax is the Fair Share Health Care Levy.

++ Quebec's share of basic federal tax is 21.34%. Even with Quebec, the percentages in column 8 will not sum to 100 because NWT (0.24%) and Yukon (0.10) are excluded.

Source: Finance Canada data.

Column 1 of Table 2 presents the range of tax credits by province. British Columbia heads the list with nine tax credits, with Nova Scotia and Saskatchewan tied for second with seven each. Note that these tax credit data refer to calendar year 1995. In 1996, Ontario had seven tax credits – a labour-sponsored investment fund tax credit, an employee ownership tax credit, a property tax credit, a sales tax credit, a political contribution tax credit, an Ontario home ownership savings plan tax credit, and an Ontario cooperative education tax credit. Several provinces also have low-income tax reductions – Ontario, Manitoba, Saskatchewan, and Alberta (from column 2) – and all provinces except Newfoundland have some form of surtax in place, usually on high income (column 3). In Ontario's case, this is the Ontario Fair Share Health Care Levy as defined earlier. For some provinces there is more than one surtax – in 1995 Saskatchewan had both a surtax and a deficit-reduction surtax, and British Columbia had a surtax as well as a Health Care Maintenance Surtax.

Finally, Manitoba, Saskatchewan, and Alberta also have a "flat tax." Saskatchewan led the way here, with a flat tax of 0.5 percent in 1985, increased to 2 percent in 1988, while Alberta and Manitoba followed with their own flat taxes in 1987 – 0.5 percent in Alberta and 2 percent in Manitoba. The federal minister of finance agreed to administer these flat taxes on a "temporary" basis, although they still remain in effect. Flat taxes run counter to the spirit and the letter of the tax collection agreements, since they allow the provinces to apply these tax rates to some version of *taxable income* (varying across the three provinces) rather than to basic federal tax. Needless to say, in the intervening years several other provinces (and Ontario on more than one occasion) have attempted to implement flat taxes, but Ottawa has always refused to administer them. This issue will be addressed below in the "tax-on-tax vs. tax-on-base" section.

Column 5 of Table 2 reproduces the provincial tax rates for 1997 – they range from a high of 69 percent for Newfoundland to a low of 45.5 percent for Alberta. The 49 percent rate for Ontario catches the province partway through its proposed income-tax reduction – from a high of 58 percent prior to the 1995 election of the Harris Conservatives to a proposed low of 40.5 percent when the tax cut is fully implemented in 1998. However, these statutory rates can be misleading since they neglect the impact of surtaxes, flat taxes, low-income tax reductions, and tax credits. Column 6 adds the value of the first three of these (surtaxes, flat taxes, and low-income reductions) to the statutory rates in column 5. These column 6 data are not really marginal tax rates. Rather, they are more like average rates; that is, the sum of revenues from these sources as a percentage of basic federal tax for province in question. For some provinces (New Brunswick and Nova Scotia), the rates fall from column 5 to 6. This is because the value of the low-income tax reduction (actually negative surtaxes in the case of these provinces) exceeds any positive surtaxes. In Ontario's case the 49.0 percent rises to 52.4 percent, reflecting the very substantial Fair Share Health Care Levy. The biggest increases occur for Saskatchewan and Manitoba and reflect their 2 percent

flat taxes. In Saskatchewan's case, its 2 percent flat tax raises as much revenue as the equivalent of a 16 percentage point increase in the column 5 tax rate. Such is the power of a flat tax, or a tax on base.

The impact of the column 1 tax credits is taken into account in the column 7 estimates of the average tax rates. These are only ball-park estimates, since the tax credit values relate to calendar year 1995, not 1997. The value of these tax credits brings Ontario's average tax rate down to 48.9 percent, from the 52.4 percent in column 6.

The final column of Table 2 presents, largely for information purposes, the percentage of the federal tax raised in each province, where the Quebec share can be calculated residually.

By way of a final comment on tax credits, surcharges, and reductions, it is important to note that they allow the provinces considerable flexibility in altering the overall progressivity imposed by the three federal tax brackets. In terms of actual provincial practice, this typically results in taxes lower than otherwise for low-income taxpayers and higher than otherwise for top-end income earners. With enough tax surcharges, reductions, and flat taxes it should be possible, in principle at least, for provinces to replicate any sort of income distribution profile for their own portion of the tax. But why go to all this trouble, when a tax-on-base approach is an option? To this I now turn.

Tax on Tax vs Tax on Base

Tables 1 and 2 provide a convenient backdrop for elaborating on a concept that will play an important role in the ensuing analysis, namely "tax on base," or "tax on income" as it is now coming to be referred to. From row 5 of Table 1, under the Tax Collection Agreements, the provinces are restricted to applying a single tax rate to "basic federal tax." This approach is typically referred to as "tax on tax." An obvious alternative would be to allow the provinces to apply their tax rate, or more likely their rate and bracket structures, to some version of the tax base. In its most general form, this would lead to full provincial flexibility in terms of tax rates and tax brackets, while at the same time ensuring that most of the system remains harmonized (for example, the definitions of income). Actually, the tax-on-base approach was much more easy to implement under the former "deductions" approach to personal income taxation than it is under the current credit approach. Under the current approach, if the provinces apply their tax structures to taxable income (row 2 of Table 2), then they will also have to decide on the value of the refundable tax credits in line 4 of the table. Since these non-refundable credits are currently assessed at the 17 percent federal rate, the provinces could assess them at, say, half this value; that is, at 8 percent. This would be the equivalent, in terms of the value of the credits, of having a 50 percent overall tax rate under the existing regime. To be sure, this is a complication that would add a line or two and at least one additional calculation to the existing filing procedure. But, it is manageable.

Two further comments are in order here. The first is that this tax-on-base approach is allowed under the tax agreements for corporate income taxation. Those provinces that are signatories to the corporate agreements (all except Ontario, Quebec, and Alberta which have their own CIT systems) can levy their tax rate or rates against taxable income. Admittedly, this flexibility in terms of the CIT is not a direct analogy to PIT flexibility, since the former does not embody "progressive" rates. The second, and probably more controversial, is that the three prairie provinces are allowed to levy "flat taxes" which are, in effect, a tax on the base. It has long been a major TCA irritant that Ottawa has prevented Ontario from initiating a tax on base while allowing Alberta, Saskatchewan, and Manitoba to have the privilege of levying such a tax.

With this institutional detail now in place, the analysis now shifts to a discussion of the pros and cons of a separate personal income tax system for Ontario. This assessment begins reviewing briefly the evidence, implications, and recommendations of the comprehensive 1983 Ontario Economic Council analysis of the case for a separate Ontario PIT.⁴

3. THE OEC ANALYSIS

The Pros and Cons of an Ontario PIT

Table 3 presents a compilation of the potential benefits of an Ontario PIT, with the final column focusing on alternative avenues through which any such benefits might be achieved. Table 4 then focuses on the potential costs of a separate Ontario PIT, with the final column again focusing on ways in which such costs might be minimized.

Although selected aspects of these costs and benefits will later be recast in the current fiscal and economic climate, the degree of annotation in these tables is sufficient that the reader is left with the task of perusing the benefits and costs of a separate PIT.

The Alternatives to an Ontario PIT

Table 5 traces the range of alternatives to the (then and now) current tax collection agreements, running from the status quo through to separate provincial PITs.

The status quo in row 1 of Table 5 still applies and was elaborated in the previous section. The first enumerated alternative to the status quo is a federal-provincial committee on the structure of the shared tax base. The intent here is to minimize the role of unilateral federal behaviour which, as noted, binds the provinces. Indeed, this proposal would allow some provincial voice in altering the major parameters of the shared PIT system. It should be noted that the federal government has opened up its tax policy process in recent years. However, the intent of row 2 is to go well beyond this.

Row 3 focuses on the tax-on-base option. In addition to providing full

Table 3
The Potential Benefits of a Separate PIT

<i>General subject area</i>	<i>Specific focus</i>	<i>Potential benefits of a separate PIT</i>	<i>Elaboration</i>	<i>Alternative avenues for achieving the same goals</i>
Growth and efficiency	Labour supply	<ul style="list-style-type: none"> - Some possibility for influencing labour supply (e.g., secondary workers) 	<ul style="list-style-type: none"> - Considerable analytic uncertainty as to effectiveness. 	<ul style="list-style-type: none"> - Programs like day care, etc., are probably just as effective.
	Labour quality	<ul style="list-style-type: none"> - A separate PIT could influence skill levels via changes such as tax credits for tuition fees. 		<ul style="list-style-type: none"> - Other provincial programs, such as the level of university funding and OSAP, probably have more impact.
	Migration	<ul style="list-style-type: none"> - PIT could be used to offset pressure to move to fiscally rich provinces. - Could be used to influence location of certain types of individuals (e.g., professional and executive class). 	<ul style="list-style-type: none"> - Relates to the fact that unequal fiscal capacities of provinces present an inducement to migration. - Would ensure that these mobile sectors faced overall taxes not much different from those in alternative locations (often in the U.S.). 	<ul style="list-style-type: none"> - Modifications in existing equalization program. - Could be accomplished via a system of tax credits if there were sufficient flexibility.
Savings		<ul style="list-style-type: none"> - Could have significant influence on channels through which agents save. 	<ul style="list-style-type: none"> - Not likely to increase overall investment unless capital markets were imperfect. 	<ul style="list-style-type: none"> - System of tax credits for savings.
		<ul style="list-style-type: none"> - Might increase total savings. 	<ul style="list-style-type: none"> - Considerable uncertainty here. 	
Corporate		<ul style="list-style-type: none"> - Would give provinces much greater flexibility in treating corporate source income. 	<ul style="list-style-type: none"> - Considerable uncertainty (would depend on capital market imperfections, characteristics of marginal investors, etc.). 	<ul style="list-style-type: none"> - Much could be accomplished through corporate tax credits.

Table 3 (Continued)

<i>General subject area</i>	<i>Specific focus</i>	<i>Potential benefits of a separate PTT</i>	<i>Elaboration</i>	<i>Alternative avenues for achieving the same goals</i>
Stabilization policy	Unincorporated business	- Could allow similar treatment (neutrality) of corporate and unincorporated enterprises.		- Difficult to achieve without a separate PTT.
	New enterprises	- Freedom to provide a range of tax credits or even follow Quebec's Stock Savings Plan.	- Capital markets likely imperfect here, so there is a possibility of significant impact.	- SBDs appear to be reasonably successful.
	Inflation distortion	- One area where Ontario could take the lead to enact changes in overall PTT regime.	- PTT provisions could make a difference here.	- More consultation between Ottawa and the provinces may lead to such changes in the existing PTT.
	Sector specific policies	- A separate PTT would provide Ontario with an additional set of tax instruments with which to influence its economic well-being.	- However, in general, expenditure policies have a larger impact on aggregate demand than tax policies.	- An extension of the tax credit approach.
	Leverage	- Ontario would no longer be required to accept federal changes which were not in its interest.		- Leverage could be eliminated by having the federal government utilize its own set of tax credits when making changes undesired by the provinces.

Table 3 (Continued)

<i>General subject area</i>	<i>Specific focus</i>	<i>Potential benefits of a separate PIT</i>	<i>Elaboration</i>	<i>Alternative avenues for achieving the same goals</i>
Income distribution	Rate and bracket structure	- Ontario would obtain freedom to determine its own rate and bracket structure.	- The tax side is only one determinant of overall income distribution. The present tax credit system (e.g., surcharges and tax reductions) also provides some flexibility.	- A move from the present 'tax on tax' system to a 'tax on base' system would also accomplish this.
	Exemptions, deductions	- Province would have complete freedom with respect to these issues. - A separate PIT would provide a framework for delivering an integrated package of socio-economic benefits to citizens (e.g., family allowance, GAINS, welfare, payroll taxes, municipal PIT sharing).	- Ontario has shown little desire to move in this direction.	- Probably requires a separate PIT. - Much could be done along these lines under the present system.
Socio-economic integration	Retaliation	- Separate PIT might be necessary if other provinces went the independent PIT route.	- This would be more in the nature of minimizing losses than striving for gains.	- Emphasizes the importance of better federal-provincial relations on these tax issues.
		- Separate PIT might be necessary if the federal tax structure did not take sufficient account of the particular economic structure of Ontario.		- Same as above.
Federal-provincial implications	Strategy	- Ontario would have more influence on the federal system.	- If there were a system of provincial PITs, harmonization might no longer be a federal objective.	- Increase in influence could also be accomplished through a federal-provincial committee on the tax structure.

Table 3 (Continued)

<i>General subject area</i>	<i>Specific focus</i>	<i>Potential benefits of a separate PIT</i>	<i>Elaboration</i>	<i>Alternative avenues for achieving the same goals</i>
Political aspects		- 'Demonstration Effects' - provincial experimentation with a PIT could lead to improvement in overall system.		- Same as above.
	Civil service	- Ontario would develop PIT expertise and in this way would have greater communication with federal government and perhaps more influence on the overall system.		- Again, the consultation route, formal or otherwise, is an alternative.
	Awareness	- Would lead to greater citizen awareness of Queen's Park as a factor in their daily lives.		
Other		- Politicians would have an additional set of instruments to deploy.		- An enlarged tax credit system or a tax on base would also enhance instruments.
		- The different structure of the Ontario economy compared to that of other provinces and the source of its economic competition (often the U.S.) imply that the federal tax system, which has to be national in scope, may from time to time be off base with respect to Ontario's needs.		- More formal consultation with the federal level over tax matters combined with some greater tax credit flexibility.

Table 4

The Potential Costs of a Separate PIT

<i>General subject area</i>	<i>Potential costs of a separate PIT</i>	<i>Elaboration</i>	<i>Measures that might reduce the costs</i>
Administrative costs	- The costs associated with personnel, enforcement, collection, etc., would be significant and unavoidable.	- Would constitute a net increase in overall PIT administrative costs, since offsetting federal savings are small.	- Integrating PIT administrative costs with other programs (e.g., corporate tax) to spread overhead.
Compliance costs	- These costs for both individuals and for corporations would also be significant and unavoidable.	- Would constitute a net increase in compliance costs for overall PIT.	- Maintaining similarity with federal PIT wherever possible.
Growth and efficiency	- To the extent that the measures under this category in Table 3 were successful they would probably invite retaliation and could degenerate into negative-sum games.	- Note that the current system also has some discriminatory measures (Quebec's SSP and the new B.C. tax credit).	- Ensuring that PIT measures were non-discriminatory vis-à-vis other provinces).
Stabilization policy	- Might weaken the federal government's ability to stabilize the economy.	- Ottawa has many other avenues (expenditure programs, transfers, sales and excise taxes, corporate taxes, commercial policy and regulatory measures).	- More coordination with Ottawa over the stabilization role. - Ottawa could still make any changes it wanted to in its own portion of the PIT.
Income distribution	- Loss of federal dominance in establishing vertical equity in the tax system.	- Provinces already have the ability through tax surcharges and increases to modify progressivity.	

Table 4 continued

<i>General subject area</i>	<i>Potential costs of a separate PIT</i>	<i>Elaboration</i>	<i>Measures that might reduce the costs</i>
	<ul style="list-style-type: none"> - Federal government might feel even less reluctant than at present to modify its tax structure. - Wider variance in marginal rates across provinces. 	<ul style="list-style-type: none"> - This is a general comment and could fall under any of the subject areas. 	<ul style="list-style-type: none"> - A federal-provincial consultation or coordinating committee on the PIT structure.
Socio-economic integration	<ul style="list-style-type: none"> - Province controls only one-third of overall PIT. Establishment of an elaborate delivery system around a provincial PIT could be made unworkable and/or outmoded by federal action with respect to its own PIT. 	<ul style="list-style-type: none"> - This is also in the way of a general comment. All activities embarked on under a separate PIT would be subject to considerable uncertainty as to how Ottawa would respond with major alterations in its share of the PIT. 	<p>Marginal rates vary considerably under the present regime.</p>
Federal-provincial	<ul style="list-style-type: none"> - The PIT could be used to erect inter-provincial impediments to the free flow of goods and factors. - Retaliatory measures by other provinces. - Retaliatory measures by Ottawa. 	<ul style="list-style-type: none"> - Would erode most of the benefits and could generate overall efficiency losses. - Same as above. 	<p>A federal-provincial code of economic and fiscal conduct.</p> <ul style="list-style-type: none"> - Same as above. - Same as above.

Table 4 Continued

General subject area	Potential costs of a separate PIT	Elaboration	Measures that might reduce the costs
Political aspects	- Increased compliance and administrative costs arising from the need to harmonize provincial PITs.		- An interprovincial tax harmonization agreement.
	- Greater tax visibility.		
	- Increased presence of special interest groups.	- Would probably not be offset by much of a decrease in lobbying at the federal level.	- Commitment to preserve harmony wherever possible with the federal system.
Other	- Erosion of citizen willingness to comply with PIT.	- The tax system is already very complex. A separate PIT would make it more so.	- Maintain harmony wherever possible with the federal system.
	- Potential for increasing overall uncertainty in the system.	- Now two levels of government would be able to make PIT changes.	
	- A move to a separate PIT is likely to be irreversible.		

Source: A Personal Income Tax For Ontario, An Ontario Economic Council Position Paper (1983, Table 16). Some minor changes have been made to the original table.

Table 5
Alternatives to a separate PIT

<i>Alternatives</i>	<i>Characteristics</i>	<i>Elaboration</i>
1. The status quo	<ul style="list-style-type: none"> - Centralized federal collection. - Minimizes administrative and compliance costs. - Provincial flexibility limited to applying single tax rate to basic federal tax and to implementing a restricted set of non-discriminatory tax credits. - Provinces required to accept all federal changes in underlying tax structure. - Consultation on such changes limited or non-existent. 	<ul style="list-style-type: none"> - Provinces are expressing increased concern over lack of consultation with respect to major and sudden federal changes. - Provinces also appear to be constrained in implementing certain tax credits.
2. A federal-provincial committee on the structure of the shared tax base	<ul style="list-style-type: none"> - No changes in the current Tax Collection Agreements. - Provinces would have equal status on the committee, reflecting the joint occupancy of the tax field and the constitutional rights of both parties to engage in direct taxation. 	<ul style="list-style-type: none"> - Could run into problems relating to federal budget secrecy in spite of recent initiatives to open up the process. - Would not prevent federal action, since there would be plenty of scope for Ottawa to enact changes after the calculation of basic federal tax (e.g., federal tax credits). After some period of notice (say three years) these federal changes would become part of the shared tax structure, even if there were no agreement on the part of the provinces. - A stronger version of this option would require joint federal-provincial agreement prior to all changes in the shared structure. Hence all controversial federal changes would have to be implemented 'below the line', as it were.

Table 5 continued

<i>Alternatives</i>	<i>Characteristics</i>	<i>Elaboration</i>
3. Tax on base	<ul style="list-style-type: none"> - Provinces would tax the federal base instead of piggy-backing on the federal tax. - Provinces would have control over their own rate and bracket structures. - Federal changes in tax rates would no longer affect provincial revenues. - Common structure for the base would still obtain. - A slight increase in compliance and administrative costs. - Would appear to fit easily within the Tax Collection Agreements. 	<ul style="list-style-type: none"> - Federal government would still have the power to alter the base and thereby bind the provinces, since base changes would affect their revenues. - Federal government would lose some control over vertical equity in the tax system; but if the provinces utilized the currently allowable tax decreases and surcharges they could come close to duplicating a tax on base.
4. An extension of the tax credit system: 1	<ul style="list-style-type: none"> - All regionally or provincially non-discriminatory tax credits would be allowed. For example, savings and investment credits that did not discriminate against assets in other provinces would be allowed. - Compliance and administrative costs would rise somewhat. - Provinces could offset some federal changes so that lack of consultation is less of a problem. - Current federal collection fee for provincial tax credits would continue to apply. 	<ul style="list-style-type: none"> - Could be combined with a joint consultative process and/or a tax on base. - Would change the current structure more in terms of degree than of substance.

Table 5 continued

<i>Alternatives</i>	<i>Characteristics</i>	<i>Elaboration</i>
5. An extension of the tax credit system: II	<ul style="list-style-type: none"> - Items under 4 would continue to apply. - Provinces could opt for tax on base (i.e., their own rate and bracket structure). - Tax credits or surcharges applicable by type of income (e.g., business income, property income, employment income) would be allowed. - Compliance and administrative costs might rise substantially, but still much less than under a separate PIT. - No tax credits or surcharges that discriminate against other provinces would be allowed. 	<ul style="list-style-type: none"> - Would require less federal-provincial coordination, since the provinces could in effect chart their course. Indeed, extending the tax credit system to this degree would give the provinces most of the flexibility they would gain from having their own PITs. Apart from their inability to impose regionally discriminatory tax credits, the provinces would also be unable to tax sources of income not included in the federal income tax base.
6. Separate provincial PITs	<ul style="list-style-type: none"> - No restrictions on provincial PIT flexibility. - Maximize compliance and administrative costs. - Minimize necessity for federal-provincial consultation on tax matters. 	<ul style="list-style-type: none"> - Would require substantial horizontal (interprovincial) harmonization in order to minimize efficiency losses.

Source: A Separate Personal Income Tax For Ontario, An Ontario Economic Council Position Paper (1983, Table 14). Some minor changes have been made to the original table.

provincial flexibility in terms of choosing rate and bracket structures, this option would isolate the provinces from changes in federal *tax rates*, since the provinces would no longer be levying their tax on federal taxes. However, changes in other parameters (such as the definition of income) that affect the tax base would continue to bind the provinces. Note that this tax on base could be combined with the row 2 option so that there could be provincial consultation (or at least some lead time) with respect to federal parameter changes.

Option 4 increases provincial flexibility in terms of initiating tax credits. For example, allowing the Fair Share Health Care Levy as a tax credit levied against taxable income would probably be illustrative of what this option would accommodate. However, as one expands the opportunities for additional tax credits and surcharges, this begins to merge into a tax on base. In other words, with enough flexibility on the tax credit, tax reduction, and surcharge front, a province could effectively generate equivalence to any rate and bracket structure. Thus, a tax on base would seem to dominate a no-holds-barred expansion of the tax credit system. Accordingly, option 5 combines both a tax on base and a more flexible tax credit system.

The final row of Table 5 is, of course, separate provincial PITs, the pros and cons of which have already been aired in Tables 3 and 4 respectively.

The OEC Recommendations

The Ontario Economic Council's overall assessment (Ontario Economic Council, 1983: 164) was as follows:

The Council recommends that the Province of Ontario not move toward a separate PIT at this time. It is not the first-best strategy to adopt in terms of dealing with the many concerns the province may have about the shared PIT.

Rather, the Council recommended the following four intermediate steps or stages (OEC, 1983: 164):

- A federal-provincial tax structure committee which would allow joint input into the determination of the common tax base.
- A move toward a "tax on base" as opposed to the present "tax on tax" system:
- An extension of the tax credit system to provide the province with more freedom to implement non-discriminatory measures within their portion of the joint PIT.
- The establishment of a "code of economic conduct" which will ensure that the internal economic union is preserved not only within the tax system but across the entire fiscal and regulatory front.

On a more ominous note, the 1983 position paper (164) also recognizes that a separate PIT for Ontario could emerge: "Nonetheless, the Council recog-

nizes that Ontario, or other provinces, could be forced into the position of designing and implementing their own PITs in the event that unilateral federal changes to the personal taxation system are deemed to be prejudicial to provincial interests." In "Council-speak," as it were, this is rather tough warning to Ottawa that its actions could precipitate an unwinding of the harmonized PIT system.

Whatever Ontario's concerns may have been circa 1983, they pale in comparison with the growing magnitude of the federal-provincial fiscal controversies that have occurred in the intervening fifteen years or so. Actually, what is surprising is that the separate PIT proposal has not surfaced earlier. In my writings on fiscal federalism, I have expressed concern that Ottawa's unilateral federalism is almost daring the provinces to go it alone. For example (1994b: 102):

Generalized offloading (directly through transfer caps and freezes or indirectly by removing sweeteners such as the previous treatment of OAS and family benefits) could well lead to a fraying of the Tax Collection Agreements and a tendency for other provinces (or groups of provinces) to follow Quebec in establishing a separate personal income tax system, or at least to insist on a switch from the current "tax on tax" approach to a "tax on base" approach which would allow rate and bracket freedom for provinces' share of the joint personal-income-tax system ... Cast in this somewhat broader framework, the issue of generalized offloading is more than a social policy issue for the provinces. It is a fiscal integrity and fiscal autonomy issue.

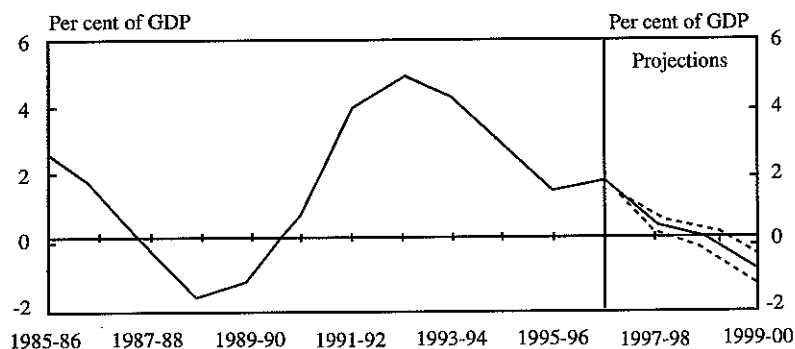
Former deputy minister of finance, Fred Gorbet (1994: 79), has expressed a similar concern:

It would be a serious mistake to underestimate the strength of conviction on the part of the western provinces, and Ontario, that they need and deserve more flexibility than the current [tax collection] agreements permit. There is a point at which they will withdraw and collect their own taxes, as Quebec does, if they cannot get this flexibility within the agreements. From a federal perspective, the ultimate trade-off in managing this issue is not between more or less harmonization within the agreement, but rather between allowing enough flexibility to convince provincial governments that it continues to be in their interests to remain within the agreement and being so rigid that the agreement self-destructs.

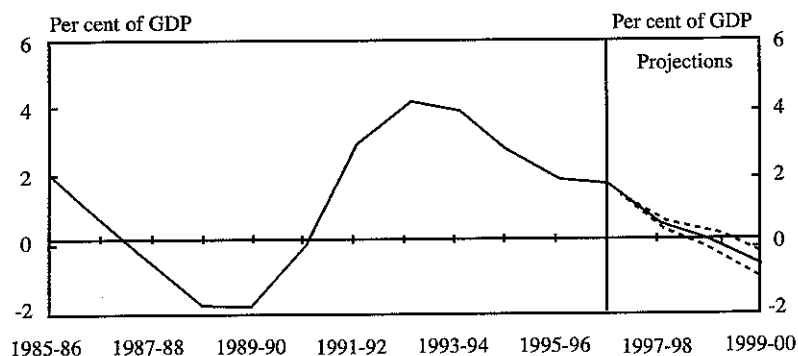
With the OEC analysis and recommendations as backdrop, we now direct attention to the case for and against a separate PIT in the context of the current economic, fiscal, and globalizing environment. To put closure to the present section, recall that the federal government backed off some of the offending features of the 1981 MacEachen budget and, as a result, the Ontario government backed off its proposal for a separate PIT.

Chart 1
Australia: General Government Underlying Deficit

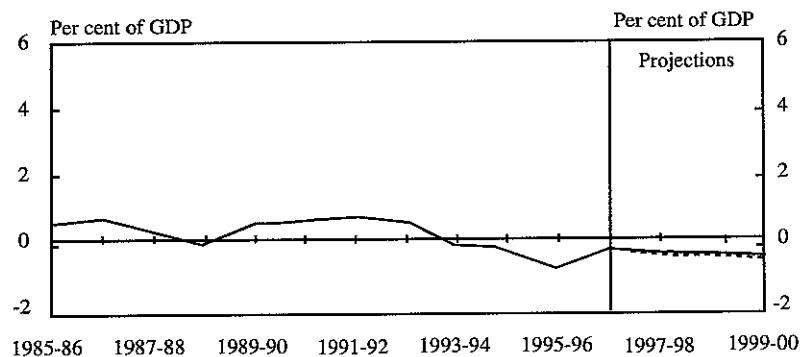
Panel A: Combined Commonwealth, State and Territory Sector



Panel B: Commonwealth



Panel C: State and Territory Sector



Source: National Fiscal Outlook, 1997.

4. ARE THERE NEW RATIONALES FOR AN ONTARIO PIT?

Tables 3 and 4 focused on the benefits and costs, respectively, of an Ontario PIT in the context of the early 1980s. Does the overall economic, fiscal, and social environment of the late 1990s alter the balance of arguments embodied in the 1983 Ontario Economic Council's position paper? In addressing this issue, attention will be directed in turn to the three traditional fiscal roles – stabilization, distribution, and allocation.

Stabilization and the PIT

A Canadian-Australian comparison. Most students of fiscal federalism assume, if not assert, that economic stabilization should be a federal (central) government responsibility. However, a cogent case can be made that, from the late 1980s onward, Ottawa has effectively abandoned its former stabilization role, especially for Ontario. This being the case, does it not follow as a *quid pro quo* that Ontario should have greater control over the cyclically sensitive PIT revenues?

To broach this topic, it is instructive to present a comparison of the Australian and Canadian federations and the manner in which they were affected by the 1990s recession. As an important initial aside, one should note that the 1990s recession ravaged both the Canadian and Australian economies. From Fortin (1996: 762):

Relative to the 1989 unemployment level, Canada accumulated 15.7 point-years of excess unemployment over 1990-95. According to OECD standardized unemployment statistics, this is significantly more than Japan (2.3 point-years), the United States (6.3) and the European Union (10.7). Our bad unemployment result has been matched only by Australia (16.3 point-years).

With this as backdrop, we observe from Chart 1 that virtually all of the resulting Australian deficit (roughly a 6 percent increase in the deficit as a percent of GDP) was absorbed by the Commonwealth government. The aggregate deficit of the Australian states rose by less than 1 percent and was in surplus by fiscal year 1993-94. At a more detailed level (not shown in the chart), this 6 percent deterioration was reflected in an increase in Commonwealth expenditures by roughly 4 percent of GDP and a 2 percent fall in revenues.

Table 6 presents comparable data for the Canadian federation. Over the 1989/90-1992/93 period, the aggregate (federal and provincial) deficit increased by 4.5 percent of GDP – from 5.1 to 9.6 percent. The federal government's share of this increase was 1.5 percentage points and the provincial share was 2.9 percentage points (with a 0.1 percent rounding error). Moreover, Ontario's deficit increase over this same period was of the order of \$12.5 billion, more than half the \$20.5 billion all-provinces' increase and

Table 6 - Canadian Federal & Provincial Governments: Surpluses and Deficits

Surpluses/Deficits (-), \$ Millions, projections in bold												
Nfld.	P.E.I.	N.S.	N.B.	Quebec	Ontario	Manitoba	Sask.	Alberta	B.C.	Provincial	Federal	Fed. & Prov.
1989-1990	-175.00	-8.00	-266.00	-24.00	-1,760.00	90.00	-142.00	-378.00	456.00	-4,323.00	-28,930.00	-33,253.00
1990-1991	-347.00	-20.00	-257.00	-182.00	-2,967.00	-3,029.00	-292.00	-360.00	-774.00	-10,060.00	-32,000.00	-42,060.00
1991-1992	-276.00	-50.00	-406.00	-348.00	-4,301.00	-10,930.00	-334.00	-842.00	-2,532.00	-22,648.00	-34,357.00	-57,005.00
1992-1993	-261.00	-82.00	-617.00	-259.00	-5,014.00	-12,428.00	-566.00	-592.00	-1,686.00	-24,920.00	-41,021.00	-65,941.00
1993-1994	-205.00	-71.00	-547.00	-250.00	-4,921.00	-11,202.00	-431.00	-272.00	-910.00	-20,193.00	-42,012.00	-62,205.00
1994-1995	-127.00	-2.00	-235.00	-69.00	-5,821.00	-10,129.00	-196.00	128.00	-414.00	-15,906.00	-37,462.00	-53,368.00
1995-1996	9.00	4.00	-201.00	51.00	-3,950.00	-8,800.00	157.00	18.00	-347.00	-11,927.00	-28,617.00	-40,544.00
1996-1997	-29.00	-7.00	5.00	74.00	-3,245.00	-7,470.00	56.00	369.00	-395.00	-8,116.00	-15,000.00	-23,116.00
1997-1998	-20.00	-17.00	4.00	26.00	-2,200.00	-6,580.00	27.00	24.00	-185.00	-8,768.00	-10,000.00	-18,768.00
1998-1999	-10.00	1.00	4.00	23.00	-1,200.00	-4,800.00	30.00	79.00	0.00	-5,622.00	-5,000.00	-10,622.00

Surplus/Deficit to GDP Ratios, Percent of GDP, projections in bold												
Nfld.	P.E.I.	N.S.	N.B.	Quebec	Ontario	Manitoba	Sask.	Alberta	B.C.	Provincial	Federal	Fed. & Prov.
1989-1990	-2.10	-0.40	-1.70	-0.20	-1.20	0.00	-0.60	-1.90	0.60	-0.70	-4.40	-5.10
1990-1991	-3.90	-1.00	-1.50	-1.40	-1.90	-1.10	-1.30	-1.70	-1.00	-1.50	-4.80	-6.30
1991-1992	-3.00	-2.40	-2.30	-2.60	-2.80	-3.90	-1.50	-4.10	-3.10	-3.30	-5.10	-8.40
1992-1993	-2.80	-3.80	-3.50	-1.90	-3.20	-4.40	-2.40	-2.90	-1.90	-3.60	-5.90	-9.60
1993-1994	-2.20	-3.10	-3.00	-1.70	-3.00	-3.90	-1.80	-1.30	-1.00	-2.80	-5.90	-8.70
1994-1995	-1.30	-0.10	-1.30	-0.40	-3.50	-3.40	-0.80	0.60	-0.40	-2.10	-5.00	-7.10
1995-1996	0.10	0.20	-1.10	0.30	-2.30	-2.80	0.60	0.10	0.30	-1.50	-3.70	-5.20
1996-1997	-0.30	-0.30	0.00	0.50	-1.90	-2.30	0.20	1.40	-0.40	-1.00	-1.90	-2.90
1997-1998	-0.20	-0.60	0.00	0.20	-1.20	-1.90	0.10	0.10	-0.20	-1.00	-1.20	-2.20
1998-1999	-0.10	0.00	0.00	0.10	-0.60	-1.30	0.10	0.30	0.00	-0.60	-0.60	-1.20

Reproduced from Courchene and Telmer (1998, Table 3.1).

over one-third of the roughly \$32.5 billion aggregate increase. Both the Canadian/ Australian and the Ontario/rest-of-provinces comparisons merit further attention.

The first point to note is that the Canada-Australia comparisons are somewhat inappropriate in the sense that the Australian states are very transfer dependent, have little access to cyclical revenues, and are not responsible for the primary automatic stabilizers on the expenditure side; for example, there is no EI program as such in Australia, and the Commonwealth government is responsible for welfare. This is obviously not the case in Canada. The provinces have, on average, a one-third share of the cyclically sensitive PIT revenues (and a smaller share of the even-more-cyclical CIT). On the expenditure side, EI payments are federal while welfare is provincial and, except for the implications of the cap on CAP, was 50 percent cost-shared during the 1990s recession.

Thus, the broad brush results in Chart 1 and Table 6 are exactly what one would expect: on both revenue and expenditure fronts the provinces bear a major role in accommodating the fiscal fallout of a recession whereas the Australian states do not.

The formal stabilization program. But the Table 6 data are only part of the Canadian stabilization story. The more interesting part is that the 1990s results reflect, in part, a wholesale abandonment by Ottawa of its former stabilization role. The details might go as follows. First, there is a separate stabilization program that is part of the overall tax collection agreements. As initially constituted, this program guaranteed that a province's revenues could not fall, at unchanged tax rates, from one year to the next. Although not articulated as such, this program was probably intended principally for the "have" provinces. This is because the "have-not" provinces have access to another revenue-stabilization program, namely equalization. As is well known, for those have-not provinces that are not part of the five-province standard (that is, the four Atlantic provinces), revenue stabilization is effectively 100 percent for the adverse economic shocks in these provinces. For example, suppose that New Brunswick's tax bases fall by 5 percent across the board, with no change in the value of the five-province equalization standard (FPS). In this situation, New Brunswick's revenues will remain *unaffected* by its economic downturn. (Note, however, that the province's *deficit* would rise if the economic downturn implied greater expenditures on welfare.) The revenue offset is not as complete for the "have-not" provinces that are part of the standard. In particular, an asymmetric shock in Quebec will lead to a decrease in Quebec's revenues in line with its proportional weight in the FPS. If its weight is 30 percent, then a 10 percent drop in revenue bases in Quebec will lead to a 3 percent decrease in Quebec's revenues *and* in the revenues of all other have-not provinces. This latter point leads to the further observation that a fall in the FPS by 5 percent would lead to a 5 percent fall in New Brunswick's revenues, whatever the prevailing eco-

conomic conditions in this province. But then it would have access to the federal stabilization program.

The second and related point is that Ottawa has altered the stabilization program in ways that lessen its stabilizing role. In the wake of the 1980s stabilization claims by Alberta and British Columbia, Ottawa altered the conditions of the formula to limit stabilization compensation to \$60 per capita. More recently (1996), the formula was further altered so that stabilization would apply only if provincial revenues from one year to the next (again at unchanged tax rates) fell by more than 5 percent. In effect, therefore, the formal stabilization program has been dramatically scaled back. In effect, Ontario's revenues (at unchanged tax rates) could fall by 5 percent a year for, say four years (for a cumulative fall of 20 percent) *without triggering the stabilization program*. While this is problematical in its own right, the implications are much more serious when unilateral federal changes in other areas – welfare and EI – are factored in. We treat welfare and EI in turn.

“Destabilizing” welfare: The cap on CAP and the CHST. Prior to the 1990s recession, welfare was 50 percent cost shared for all provinces. What this meant was the federal government was sharing in the stabilization costs of a recession-induced increase in welfare. Indeed, stabilization on the expenditure front was very effective. The first line of defence was the generous federal UI (now EI) program. For persons who exhausted UI benefits and were then forced onto provincial welfare rolls, Ottawa picked up half the cost of the existing welfare payments. Had these programs remained intact throughout the 1990s recession, the provincial share of the deficit burden in Table 6 would have been much reduced, especially for Ontario.

But they did not remain intact.

The first and most significant federal initiative was the imposition of the “cap” on the Canada Assistance Plan (CAP) in 1990. Henceforth, the growth of federal CAP transfers to the three have provinces would be limited to 5 percent per year. While applicable to all three have provinces, this was in reality a poorly disguised attempt by Ottawa to insulate itself from the implications of an enrichment in Ontario's welfare system (Courchene and Telmer, 1998: Chapters 5, 6 and 8). Originally estimated to save Ottawa \$365 million in 1992/93, the onset of the recession meant that the cost to Ontario alone in this fiscal year was \$1.7 billion and the cumulative cost to Ontario is now well in excess of \$10 billion (Courchene and Telmer, 1998, Chapter 6). In the present context, the key point is that in the face of Ontario's most dramatic economic downturn in the postwar period and, more importantly, in the face of mushrooming welfare bills (from \$2.6 billion in 1989/90 to \$6.7 billion in 1994/95), Ottawa had abandoned Ontario on the welfare stabilization front.

As already noted, a case can be made that the cap on CAP was designed to insulate Ottawa's fiscal position from an “inappropriate” enrichment in Ontario's welfare system. However, as Courchene and Telmer (1998) point out, had the mid-1980s status quo prevailed, that is, no cap on CAP and no

change in Ontario's welfare system, CAP payments to Ontario in the 1990s recession would have been well in excess of actual CAP payments under the cap. In other words, the cap on CAP *more than isolated* the federal treasury from Ontario's welfare enrichment.

With the advent of the CHST in the 1995 federal budget, Ottawa block-funded welfare and rolled it into the CHST. Two implications of this policy change are relevant. The first is that 50 percent welfare cost-sharing was *eliminated for all provinces*. That is, Ottawa has abandoned any stabilization role in terms of welfare. The second is that the discrimination against Ontario in terms of the cap on CAP was carried over to the CHST: the welfare entitlements rolled into the CHST for Ontario (and for two other have provinces) related to the cap on CAP values and not one-half of the actual Ontario welfare bill. This stripped Ontario of roughly \$2 billion in CHST entitlements. To be sure, this discriminating CHST treatment for Ontario is not a stabilization issue, *per se*, but it is a crucial component of Ontario's concern with the existing federal-provincial fiscal relations, which includes the Tax Collection Agreements.

Pro-cyclical EI changes. The fiscal vulnerability of the provinces to the 1990s recession arising from the downsizing of the formal stabilization program and (for Ontario, B.C. and Alberta) of the cap on CAP was exacerbated by the mid-recession rollbacks in EI, both in terms of eligibility and generosity of the program, and by the hike in EI premiums in the depths of the recession. The result was to enhance the reliance of Canadians on welfare where, in Ontario's case, the province was, at the margin, spending 100 cent dollars.

Ottawa has, of course, realized the inappropriateness of these pro-cyclical changes in EI. However, the federal solution to this problem is adding insult to injury. Specifically, Ottawa is bringing roughly one-third of overall EI premiums (\$7.1 billion for the current year) directly into federal consolidated revenues in order to build up an EI "stabilization fund" to ensure that EI premium increases can be avoided in any future recession. But this is a "virtual" fund: it does not exist, since these premium revenues are part and parcel of Ottawa's general revenues. Presumably, however, Ottawa is morally committed to utilize this virtual fund to accommodate any future recession-triggered surge in EI benefits. There is a related issue that irks Ontario. This virtual fund is now well in excess of its originally intended size.⁵ Ontario's enunciated preference is for Ottawa to reduce EI premiums. In part, this reflects Finance Minister Ernie Eves's desire to reduce EI payroll taxes, especially in light of the forthcoming major increase in CPP premiums. But there is another reason: while Ottawa is pocketing \$7.1 billion of EI premiums, Ontario and the provinces generally are suffering *PIT revenue losses*, since EI premiums are a non-refundable credit in terms of row 4 of Table 1. This is yet another example of Treasurer Eves's concerns that the provinces are forced to accept PIT implications that they do not agree with.

By way of summary to this point, the federal government has clearly opted out of its traditional provincial stabilization role. To be sure, this statement refers to the role of specific stabilization instruments, such as the formal stabilization program and the former cap on CAP. The operations of the overall fiscal system still retain a stabilization role. For example, if federal expenditures across provinces are fixed, then an economic downturn in a given province will trigger some automatic stabilization, since federal PIT and CIT revenues from this province will fall. And the EI program, even if scaled down, does still provide stabilization for negatively impacted provinces. Nonetheless, the traditional stabilization rationale for Ottawa maintaining control of the cyclically sensitive revenue sources loses force if the federal government is abandoning explicit stabilization.

We hasten to add that none of this is meant to imply that the provinces would do a stellar job in terms of stabilizing their own economies. As Courchene and Telmer point out (1998: Chapter 5), the Peterson Liberals would earn low marks for their stabilization performance. On the other hand, no one would award Ottawa high marks for its fiscal performance in the 1980s which, in turn, meant that it had little choice on the fiscal front but to exacerbate the effects of the 1990s recession.

The implications arising from the above analysis of the interaction between federal stabilization and the case for an Ontario PIT would seem to point in the direction of Ottawa re-entering this field in some way or else having to address the legitimate concerns of the provinces, including proposals for greater PIT flexibility. For the former to have any meaning, one modification that is essential is that the federal government move away from deficit targets that "bind" each year. By definition, this implies no room for manoeuvrability in terms of explicit stabilization for major downturns (that is, those that exhaust the "contingency reserve"). Much more appropriate are targets that "balance" the budget over the business cycle. Balance is put in brackets because the chosen deficit target over the cycle could be a surplus rather than a zero deficit level. Beyond this initiative, Ottawa might consider introducing a new stabilization facility or reworking the existing one. In the European Union/EMU context, Goodhart and Smith (1993) proposed a stabilization facility that would (i) address asymmetric shocks to individual member countries based, say, on deviations from per-capita income trends, (ii) be timely but apply for a limited duration, and (iii) be a pure "stabilization" (not a redistribution) facility, one characteristic of which would be that *ex ante* any one state has the same probability of receiving stabilization as any other. It would appear that the existing federal stabilization program could be reworked to incorporate these features. As the situation now stands, and as noted earlier, Ontario could, for example, see its revenues fall by 5 percent for four consecutive years (for an overall revenue shortfall of 20 percent) and yet this would not trigger the federal stabilization program, given the annual 5 percent threshold. In tandem with the provisions elaborated above it is not unfair to assert that the federal government has effectively abandoned its stabilization role in the federation.

One could argue that the provinces could engage in stabilization under the existing Tax Collection Agreements, by altering their single tax rate and/or their rebates and surcharges in a countercyclical fashion. This is, of course, true. But there is no longer an overarching stabilization concern that would stand in the way of allowing the provinces full control over their share of the PIT. More to the point, the first line of the federal defence in terms of not transferring further PIT room to the provinces (for example, granting all provinces the additional 16.5 PIT points that Quebec has, or converting cash transfers to additional PIT points) has traditionally been that Ottawa needs to maintain adequate control over the PIT for stabilization reasons. This reason is disappearing.

I conclude this discussion on the stabilization-PIT nexus by referring back to the Canadian-Australian comparison. The decentralized nature of the Canadian federation is such that one would not expect the federal government to accommodate the full fiscal brunt of a major recession, as appears typical of the Australian federation. On the other hand, the situation where the provinces' share of the fiscal burden of a recession is 66 percent, as it is in the Table 6 data, is likewise unacceptable. The onus here is on the federal government to re-enter the stabilization game or else suffer the consequences – and one consequence could well be that Ontario, among other provinces, will come to the view that if Ottawa is abandoning its stabilization role, then this provides a powerful incentive to go its own way on stabilization via obtaining greater flexibility over its share of the PIT.

Distribution and the PIT

In the intervening years since 1983, the overall distributional case for greater Ontario PIT flexibility has strengthened considerably. However, as will be emphasized in the ensuing analysis, much of this greater flexibility can be achieved via a tax on base rather than a separate PIT. We begin by focusing on the distribution of taxation capacity between Ottawa and Ontario (and the provinces generally), recognizing that some readers may view this more as an allocation rather than a distribution issue.

Vertical fiscal imbalance. Vertical fiscal imbalance is defined here as the relationship between revenue access and expenditure responsibility between the two levels of government. On the revenue side, as a result of the implications of federal deficit shifting on the one hand and the "crowding out" of provincial sales tax flexibility by virtue of the introduction of the GST on the other, the provinces find themselves revenue constrained, at least in comparison to their early 1980s situation. This is compounded on the expenditure side by the devolution of areas like training and the elimination of shared-cost funding for welfare. However, it may well be that there is an offset in the making: if the federal government follows through with its intention to enhance the monies delivered via the proposed CTB (Child Tax Benefit), this could free up some provincial fiscal room. But the likelihood is that Ottawa would itself offset this by compensating reductions in the

value of CHST entitlements.

In any event, there appears to be a case, on grounds of the increasing vertical fiscal imbalance, for greater provincial PIT flexibility and, indeed, a larger share of the PIT. As noted, a tax on base would likely suffice here, rather than a full-blown PIT. The obvious question then arises: Why could this fiscal flexibility not be realized by increasing provincial taxes under the existing PIT regime? To this we now turn.

Vertical income distribution. Under the existing Tax Collection Agreements, not only does Ottawa set the basic tax rate structure (i.e., 17 percent, 26 percent, and 29 percent), but the tax-on-tax requirement implies that provincial taxes will simply "gross up" these tax rates. For example, a 50 percent provincial tax implies overall marginal rates of 25.5 percent, 39 percent, and 43.5 percent. To be sure, with creative (positive and negative) surcharges, the provinces can alter this progressivity somewhat, but without access to levies on the base this flexibility is limited.

Somewhat speculatively, we argue that there are at least two problems, albeit related, with the overall progressivity. The first is that the (middle income) 26 percent federal marginal rate (which applies to taxable incomes as low as \$29,590) is simply too high. Intriguingly, when the current rate and bracket structure was introduced in the mid-1980s, this was also Ottawa's view. Recall that the role of the second round of tax reform (the one that introduced the GST) was to deploy some of the new revenues to decrease the middle-income tax rate. This never came to pass. The result is that Canadians with taxable incomes as low as \$30,000 are subjected to essentially a 40 percent overall marginal tax rate (for provinces whose tax on tax is 50 percent). In the context of the PST/GST sales tax regime and the soon-to-explode CPP premiums, this is a very high marginal rate indeed. With their own rate and bracket flexibility, it is most unlikely that the provinces would mirror this degree of progressivity from low-income to middle-income earners. Provincial options would involve lessening the degree of progressivity or increasing the income threshold where the middle tax rate would begin to apply.

The second reason is related. With 40 percent marginal tax rates likely applying to graduates of our universities (and closer to 50 percent if one includes payroll taxes), Canada risks an exodus of our human capital to the United States. In a sense, this is an allocation issue, but one which stems from the income-distribution features of the existing Tax Collection Agreements. This challenge is particularly severe for Ontario, since it is the home of footloose industries where marginal tax rates loom large in terms of location decisions. The ongoing decrease in Ontario's PIT rate from 58 to 40.5 percent (in 1998) reflects in part this cross-border dilemma. With full rate and bracket flexibility, one can be fairly certain that the province would not have reduced overall marginal rates proportionally across the board, as it is required to do under the Tax Collection Agreements.

The general point, and one elaborated further in the next section, is that

the differing economic circumstances of the provinces argue for different degrees of progressivity, depending in part on the tax regimes of their principal competitors. The federally imposed, one-size-fits-all progressivity of the tax-on-tax regime is outmoded and inappropriate in a federation where the provinces are so economically and industrially diverse. One could argue that under the current system the provinces had the ability, via a middle-income tax reduction, to address this issue. But a mushrooming of tax credits, surcharges, and reductions to generate the desired degree of progressivity would become incredibly cumbersome.

While this is a powerful rationale for greater PIT flexibility, it need not imply a separate PIT: it can be accommodated via a shift from the current tax-on-tax approach to a tax-on-base regime. However, if Ottawa remains steadfast in terms of its refusal to allow a tax on base, then these concerns do become a powerful rationale for a separate Ontario PIT.

Social policy. The final argument on distribution grounds for a separate PIT relates to what Table 3 refers to as "socio-economic integration," namely utilizing an Ontario PIT as the framework for delivering an integrated package of socio-economic benefits to citizens. In more detail, all provinces are now moving in the direction of integrating their various human-capital subsystems – the school-to-work transition, the welfare-to-work transition, and the education-apprenticeship-training nexus. The potential role of a separate PIT in these areas is twofold. The first is as a "reconciler" of benefits, as it were – to the extent that these socio-economic programs involve income testing or refundable credits, then control over the PIT system provides the natural integration and reconciliation instrument for these subsystems. The second is closely related: with its own PIT system, Ontario could embark on a system of tax credits for training and apprenticeships among other areas where these, too, would be integrated into the PIT system.

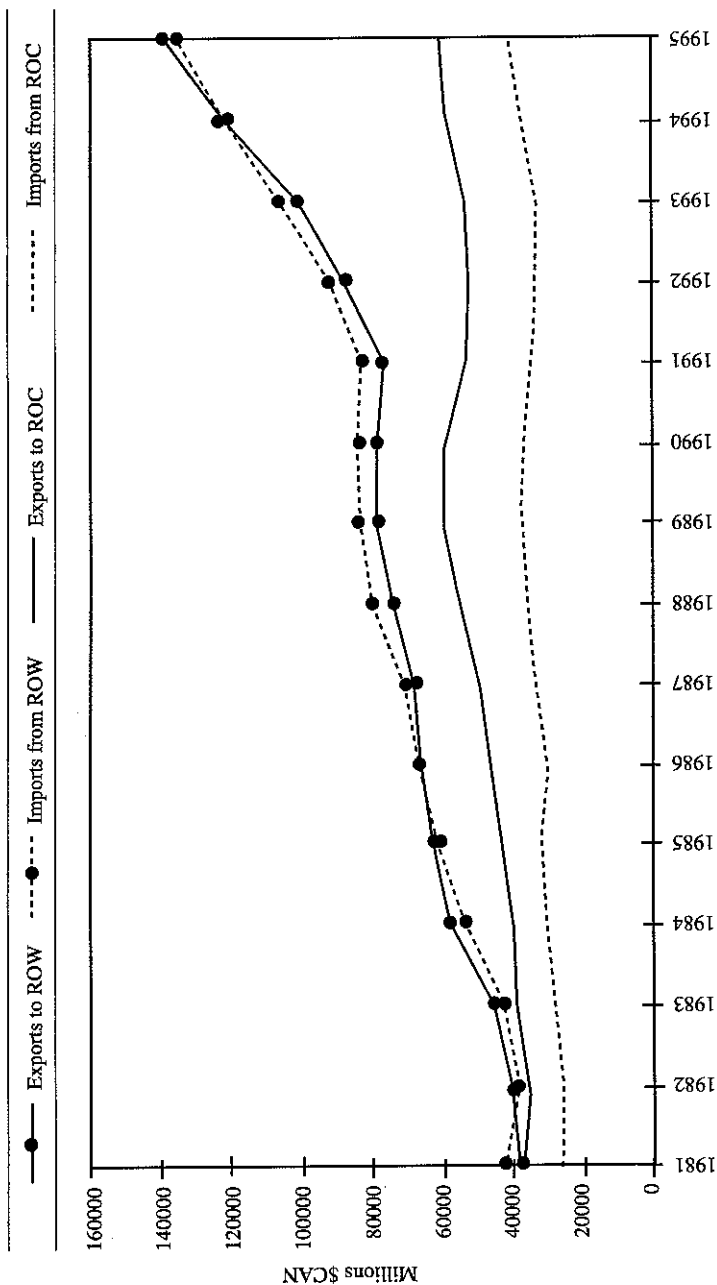
Unlike the earlier two rationales, a tax on base may not suffice for socio-economic integration and reconciliation. This is so because even under a tax on base Ottawa is unlikely either to contemplate three or six month reconciliation/delivery of benefits or to provide the province with full client information, both of which would be required for a comprehensive socio-economic system built around the personal income tax.

The unanswered question in all of this is whether Ontario *would* design and deliver its human-capital systems around the integration potential of a PIT. But one answer is that under the present TCA it cannot even contemplate this option.

Allocation and the PIT

Much is made about the virtues of the existing Tax Collection Agreements in preserving and promoting the internal economic union and, more generally, the harmonization of much of the system across provincial boundaries (except for Quebec in selected areas). However, with exports to the rest of

Chart 2 - Ontario Trade



Reproduced from Courchene and Telmer (1998, Chart 9.1)

the world (predominantly to the U.S.) now accounting for 45 percent of Ontario's GDP, and with Ontario's international exports expanding much more rapidly than its exports to other provinces (see Chart 2), the relevant tax harmonization for the province is less and less with, say, Alberta, than it is with Michigan, Ohio, and New York. This is true for other provinces as well: Alberta must keep a close watch on the tax regimes of the oil-producing Texas Gulf states, while British Columbia cannot get too far offside with the American Northwest and the Pacific Rim generally. To a large degree, this is a corporate tax issue and this explains, in part at least, why Alberta and Ontario have their own corporate tax regimes. But the personal income tax system also has significant potential for enhancing provincial competitiveness vis-à-vis the provinces' main trading partners. And again, one size may not fit all.

Most of the arguments for a separate PIT on the allocation front were elaborated under the "growth and efficiency" row of Table 3. More to the point, few of these could be accomplished via a tax on base: they require full PIT flexibility; for example, allowing similar treatment of corporate and unincorporated enterprises, adjusting capital income to eliminate the inflation component, or privileging certain types of savings and investment flows. Indeed, given the dramatic changes in the labour market and, in particular, the increase in self-employment, ensuring comparability between incorporated and unincorporated enterprises is likely to emerge as a major issue. This would require a full-blown provincial PIT.

Unfortunately, to elaborate further on the nature or the value of the resulting benefits from a separate PIT on the allocation front requires a degree of empirical research that is well beyond the scope of this paper. Suffice it to say that if Ontario is indeed making the transition from Canadian heartland to a North American region state (as Courchene and Telmer, 1998, claim) then the "allocation" or competitive rationale for a separate Ontario PIT will progressively become more dominant and, probably, overwhelming. In effect, this is what it means to become a North American region state. (This is a message directed not to Ontario, but rather to Ottawa.)

Recapitulation

The general thrust of this section has been to focus on reasons why the economic and fiscal climate may have altered over the fifteen years since the Ontario Economic Council rendered its verdict on whether Ontario should opt for its own PIT. Implicit if not explicit in the above analysis were arguments that enhanced the case for a separate Ontario PIT; that is, there was scant reference to the range of downsides noted in Table 4. Section 6, which focuses on the likely implications of a separate Ontario PIT, will embrace some of these downsides. Prior to so doing, however, it is instructive to focus on potential rationales for a PIT that transcend the specific operations of the TCA.

5. AN ONTARIO PIT AS BARGAINING STRATEGY

As Courchene and Telmer (1998) point out, from the Peterson Liberals onward, Ontario has been increasingly offside with federal policy in general and with Ottawa's treatment of Ontario within the federation in particular. For the Ontario of David Peterson, most of the criticism of the federal government centred on Ottawa's macro policy stance – the FTA, the GST, and the price stability strategy (including the dramatic rise in exchange rates during the latter part of the Liberals' reign). One should note that this feeling was mutual – Ottawa felt that Peterson government's mid-teens spending spree in the latter part of the 1980s was serving to overheat the Ontario economy in the very time frame that the Bank of Canada was actively launched on its price stability trajectory. Arguably, the result of these divergent policy paths was that interest rates and exchange rates soared to heights that otherwise would not have occurred.

However, as already noted, the most damaging and dramatic initiative by far was the federal decision to cap the growth of Ontario transfers under the Canada Assistance Plan. There is little doubt that the principal target here was Ontario – the province had substantially enriched its welfare system in the late 1980s, and under the existing CAP arrangements Ottawa would be responsible for 50 percent of the resulting welfare bill. In order to deflect the fact that Ontario was the principal target, Ottawa applied this 5 percent maximum growth of CAP transfers to all three "have" provinces – Ontario, Alberta, and British Columbia. Because the cap on CAP was introduced during the last few months of the Peterson regime, the full fiscal impact of the cap only emerged under Bob Rae's NDP, aided substantially by the severity of the 1990s recession. While the cumulative fiscal fallout for Ontario of the cap on CAP was well over \$10 billion (and still counting!), this was not the only policy area where Ontario felt that it was receiving discriminatory treatment from Ottawa. In a letter (dated 2 February, 1994) directed to the 98 Liberal MPs (out of the Ontario total of 99) elected in Chrétien's 1993 victory, Rae noted:

Ottawa spends 27 per cent of its training budget in Ontario. But Ontario has 38 per cent of the national workforce and 36 per cent of Canada's unemployed. If Ontario received funding that matched its workforce, it would receive about \$370 million more in 1994–95 ... Ontario currently welcomes about 55 per cent of Canada's immigrants. But our province receives only 38 per cent of federal funding for their settlement and training. Funding based on the level of help which applies in the rest of Canada would provide Ontario with about \$110 million more in 1994–95.

These fiscal shortfalls were in addition to Rae's estimate of the \$6.8 billion shortfall in transfers accumulated since 1990. Premier Rae actually took the

unusual step of commissioning Informetrica Inc. to document the comparative federal treatment of Ontario across a dozen or so policy areas (Appendix 6.A of Courchene and Telmer [1998] summarizes these Informetrica studies.) Hence, "fair shares" federalism became the Rae slogan. For a time the Rae government viewed this inequitable treatment as a reflection of the "continentalist" policy thrust of the ruling Mulroney Tories. However, when the Chrétien Liberals also embraced the GST, the FTA, and implemented NAFTA and, more significantly, when Finance Minister Paul Martin rolled the inequitable cap on CAP into Ontario's entitlements under the new CHST, the Rae government came to view the Ontario discrimination as systemic.

When the Harris Conservatives gained power in 1995, they initially attempted to bridge this Ontario-Ottawa policy divide. They bought into the entire macro philosophy – NAFTA, the GST, monetary policy and deficit reduction, and they even offered to integrate Ontario's PST with the federal GST. However, as the months passed, the Harris government, too, came to view this discrimination as systemic. A critical initiative here was the \$1 billion "gift" to the three Atlantic provinces for agreeing to harmonize their PSTs with the GST. Indeed, within a year of taking power, Ontario's Intergovernmental Affairs Minister Dianne Cunningham articulated most of the Rae concerns in an address to the Council of Canadian Unity (June 14, 1996). Ontario is now one of only two provinces that have not signed a bilateral agreement with respect to the devolution of training, because the federal monies associated with the devolution are deemed to be wholly inadequate. And Ottawa's ongoing pocketing of \$7.1 billion of EI premiums, roughly 40 percent of which come from Ontario workers, represents yet another area of contention.

While this has been a lengthy detour, the purpose of the exercise is to offer a subjective and wholly speculative view that the "fed-bashing" in Ontario's 1997 budget transcends the confines of the Tax Collection Agreements and reflects the utter exasperation with Ontario's overall policy treatment at the hands of the federal government. In turn, this raises the issue of whether the PIT proposal is, as was the case with previous Ontario PIT initiatives, largely a strategic initiative designed to counter this systemic discrimination within the federation.

We do not know the answer to this question. What it would suggest, however, is that a few compromises on Ottawa's part with respect to the operations of the Tax Collection Agreements will not, of and by themselves, bridge the policy conflict between Ontario and Ottawa: it transcends the more immediate PIT concerns. The time has clearly come for an Ontario-Ottawa "fiscal summit" as it were. Indeed, all provinces should be involved, since the implications of this policy divide could spill over in a dramatic way to the rest of the federation. What the above analysis suggests is that a separate Ontario PIT is a viable and, in aspects, an appealing provincial system should Ontario continue to perceive itself as being unfairly treated within the federation.

6. THE IMPLICATIONS OF A SEPARATE ONTARIO PIT

In this section we assume that a separate Ontario PIT is a *fait accompli*. The issue then becomes: What are the likely implications for the federation? That is, for Ontario, for other provinces, and for the federal government. Much of the ensuing analysis will be motivated by the range of entries in Table 4.

Rate and Bracket Freedom

The first and most obvious implication is that Ontario will gain rate and bracket freedom over its own portion of the PIT system. Phrased differently, Ottawa will lose control over the progressivity of the Ontario portion of the PIT. Of and by itself, this does not appear to be a major issue. First, marginal tax rates already differ substantially across the provinces (see column 5 of Table 2). Second, Ottawa will still have a dominant role in terms of seniors and, if it increases the Child Tax Benefit, in terms of children. This means that what it surrenders is control over the Ontario portion of PIT progressivity as it relates to income-earning Ontarians. There may well be a silver lining in all of this (elaborated below) since Ontario will now have tax flexibility in terms of forging PIT integration of the various human-capital subsystems (for example, welfare to work) as they apply to adult Ontarians. Third, Ontario rate and bracket flexibility, *ceteris paribus*, will not affect the overall harmony of the system since what matters most for harmonization are tax bases, not tax rates.

Because we have limited Ontario's flexibility only to the province's rate and bracket structures, the above analysis is really an assessment of a tax on base, not of a separate PIT. What is of interest is that the implications of a tax on base are rather benign, at least as we assess them. However, a separate PIT is much more than a tax on base and, once we allow for the inevitable other changes that it will usher in, the implications cease to be benign.

Base Changes

The first point to note here is that a separate PIT will address one of Finance Minister Ernie Eves's major concerns quoted in the introduction:

The current Tax Collection Agreement also makes Ontario vulnerable to federal base changes which automatically affect Ontario's revenues. The terms of the current arrangement leave the Province with no choice but to automatically adopt most federal income tax changes, including those that the province does not support. (*Budget Papers*, 1997: 83)

In contrast, under a separate PIT, Ontario will be free to redefine its tax bases

for PIT purposes. For example, the province could define capital gains in real (after-inflation) terms or it could even exempt them entirely from income. Since it would be difficult to argue that giving favourable tax treatment for capital (especially if this was designed to remove the inflation component from taxation) would run counter to any constitutional provision relating to preserving the economic union (and, indeed, might have solid economic arguments to buttress it), there is precious little that Ottawa could do in response to any such Ontario initiative. However, there are ways of altering tax bases that would be much less benign in terms of their economic union implications. Now that we have broached the economic union issue, it is appropriate to focus on it in more detail.

Implications for Internal Economic Union

With Ontario's economic focus increasingly directed north-south, maintaining east-west harmonization on the tax front becomes relatively less important. Given the evidence in Chart 2, perhaps this should be rephrased to state that embracing north-south harmonization is becoming relatively more important – from a position of rough equality in 1981, Ontario's international exports (which are predominantly to the U.S.) are now more than twice Ontario's exports to its sister provinces. Thus, one can be fairly confident that Ontario would tailor its new-found PIT freedom to enhance its competitiveness vis-à-vis the tax systems of its major trading partners which, to repeat, are not Alberta or Nova Scotia but Ohio, Michigan, New York, and other Great Lakes states.

Nonetheless, it would still be the case that any overt discriminatory measures (for example, exempting capital income from Ontario-based companies from Ontario taxation, and not companies headquartered elsewhere in Canada), could and hopefully would be struck down by the Courts. One alternative approach to all of this would be for the overall system to enter into one or more intergovernmental agreements in terms of the economic union (along the lines of my 1996 ACCESS model, for example). Along similar lines, Ottawa and the provinces could enter into an agreement on a "code of fiscal conduct," as recommended by the Ontario Economic Council. There is some precedent for this. On the corporate tax side, all provinces (including Ontario, Quebec, and Alberta, which have their own CIT regimes and are, therefore, not signatories to the Tax Collection Agreements for the corporate tax) have agreed to a common formula that allocates profits across provincial jurisdictions for corporations that operate in more than one province. This ensures that there is no double taxation or zero taxation of corporate profits, unlike the case in the United States.

However, these initiatives would likely be geared towards prohibition of tax initiatives whose thrust and intent is to fragment the Canadian economic/fiscal union. Yet, as noted, many of the likely measures that Ontario would undertake in order to harmonize its system with those of the

Great Lakes states would not fall into this "overt discrimination" category.

Decentralization and an Ontario PIT

Courchene and Telmer in *From Heartland to North American Region State* (1998) argue that as a result of increasing north-south integration, federal deficit-shifting, federal devolution of powers, and overt federal discrimination against Ontario, the province is not only casting its policy eyes southward but in the process Queen's Park is becoming a more influential force in the economic and social life of the province. A separate PIT will likely significantly enhance this shift.

Several facets of this have already been highlighted. First, Ontario would likely capitalize on its PIT flexibility in terms of privileging the growing trend towards self-employment. For example, control over PIT parameters would allow more equitable treatment between incorporated and unincorporated enterprises. Second, it would allow Ontario to utilize the PIT system to rationalize its human capital subsystems – school/training/apprenticeship to work, welfare to work, and so on. In addition, the Harris government 1997 budget proposals in terms of fostering linkages among human capital, enterprise, and innovation (Courchene and Telmer, 1998: Chapter 7) will become much easier if the province controls its portion of the PIT. Third, and relatedly, if and when Ontario does rationalize its welfare/training/apprenticeship subsystem, it will only be a matter of time before the province presses for some control over EI in order that this, too, can be integrated into this subsystem. Ottawa may well refuse this request, since EI is a federal responsibility, but pressure will surely be brought to bear on the federal government. Likewise, once Ontario has its own PIT, it will surely mount a case not only for a conversion of the CHST cash transfers into further PIT tax points but, in addition, for access to the additional 16.5 PIT points that Quebec now has. Again, the federal government is unlikely to capitulate to these demands.

This litany of examples can easily be extended. For example, on the health-care front, Ontario would now have the capability (but perhaps not the right) to enact a "delayed user fee" for medical services that would be run through the PIT, as recommended by the Ontario Economic Council (1976) and reiterated in Courchene (1987). This would be a very progressive user fee since it would be assessed against Ontario taxable income – low-income Ontarians could be exempt since they would have no taxable income and the user fee would increase with increasing income up to some maximum fee.

What appears clear from this analysis is that a separate PIT for Ontario would lead to further decentralization of the federation. Moreover, this decentralization would not inherently be about a "power grab" for its own sake on the part of Ontario. Nor would it be about beggar-thy-neighbour federalism. Rather, as Courchene and Telmer (1998) point out, it would be all about how Ontario would privilege itself and its citizens in the province's new economic environment – as a North American region state.

Ontario Taxpayers and a PIT

What is likely to give Ontario politicians second thoughts relates not so much to the above analysis, which can on balance probably be construed as benefitting the province as a North American region state, but rather the response of Ontario taxpayers. Their compliance costs would obviously rise, since there would now be two separate tax forms to file. Beyond this, there is the cost of a new tax-collection bureaucracy, or perhaps an arm's-length organization if collection is delegated to the private sector as hinted by Finance Minister Eves.

While we have not attempted to assess these costs, it may be instructive to note that, in the context of the 1983 OEC reports, the estimated overall administrative and personnel costs of an Ontario PIT were put at \$120 million annually, with a once-and-for-all capital cost of \$60 million. These estimates were based on figures supplied by Revenue Canada. The Ontario Treasury also offered three estimates – ranging from a low of \$56.1 million to a high of \$116.3 million, with set-up costs estimated at \$29–\$34 million. (Both estimates appear in chapter 15 of the OEC position paper.) If one assumes some middle range, say, \$75 million to \$100 million (as the OEC does), this would convert to a range of \$124–\$165 million in 1997 dollars (that is, CPI-adjusted from 1982).

Converted to 1997 dollars, the Ontario Economic Council's estimate of compliance costs (for both employers and employees) would be in the range of \$173–\$470 million. This range is very wide, since considerable uncertainty attaches to these compliance costs.

Valued at the mid-points of both the ranges, the resulting collection and compliance costs for a separate Ontario PIT would, from an extension of the Council's 1983 estimates, be \$465 million for 1997. Since the 1996/97 value of Ontario PIT revenues is about \$15.5 billion, this yields a collection/compliance cost ratio of 3.0 percent.

Intriguingly, Erard and Vaillancourt (1993) estimate the combined collection and compliance costs of a separate Ontario PIT (run along the Quebec PIT lines) to be 3.1 percent of total taxes collected. As with the Council's estimates, compliance costs are the major component of total costs.

It will be of considerable interest to compare these estimates with those that will presumably be forthcoming from the Ontario Finance Ministry, in connection with its proposed contracting out of the collection system to the private sector.

Note that these will be *overestimates* of the net cost to Ontario, since the province will no longer be paying the administrative fees to Ottawa in connection with the various Ontario tax credits. And if Finance Minister Eves is correct in claiming that Ontario is losing money from the way in which Ottawa implements the TCA (more on this later), the net costs to Ontario will be lower still.

Whatever the costs to Ontario and, in terms of compliance, to Ontarians, these will largely be *net increases* in the costs of the PIT. This is obvious for

compliance costs, since taxpayers will still have to fill out the federal tax form. Surprisingly, perhaps, this is also the case for collection costs – apart from some potential federal savings in administering Ontario's tax credits, Ottawa's collection costs will largely remain unchanged (OEC, 1983). This is so because the calculation or two relating to the Ontario portion of the overall PIT form represents a very small component of the overall federal PIT collection costs associated with assessing the income tax forms for Ontario filers.

Beyond these dollar costs, there is the sheer political cost of introducing a separate PIT. Ontarians will realize, and in any event will be inundated with federal rhetoric, that a separate PIT for the province could have major implications for the evolution of the federation. On the other hand, the process of implementing an Ontario PIT would surely be less difficult than any number of the ongoing institutional revolutions that Ontario is living through under Premier Harris.

Impact on the Other Provinces

Were Ontario to opt for its own PIT, one can probably forecast that some other provinces will follow suit. Alberta easily comes to mind. Recently, Alberta Treasurer Stockwell Day indicated that Alberta might look into "delinking" the province from the Revenue Canada taxation agreements (Chase, 1997). Whether this involves more than a move towards tax on base, which both the Treasurer and the Alberta Liberal finance critic support, and actually embraces a separate Alberta PIT is not fully clear. In any event, the longer-term likelihood of a separate Ontario PIT is not two separate provincial PITs (Ontario and Quebec), but several. This will serve to compound some of the earlier implications, for example, the implications for the internal economic union and, more generally, for enhanced decentralization.

Implications for Ottawa

As noted *inter alia* in the above analysis, an Ontario PIT will not be a welcome initiative from Ottawa's perspective. It will lose control over the overall progressivity of the system. It will also lose the existing leverage of having any and all of its tax changes automatically reflected in the provincial portion of all provinces' PITs (except, of course, for Quebec). Ottawa, along with the provinces, could face the challenge of reconstituting the Canadian fiscal union and, perhaps, even the economic union. It might oversee a further decentralization of the system. And so on.

On the other hand, Ottawa does gain some freedom in setting tax parameters, since they will not carry over into the Ontario PIT (or into other provincial PITs). But this seems to be poor compensation when set against its loss in potential influence, as elaborated above.

There is also a possibility that federal-provincial conflicts could arise. For example, under the current arrangement, provincial workers' compensa-

tion benefits are not taxable. Ottawa could withdraw this privilege. However, this would be difficult politically since it would create problems for all provinces and not just Ontario. (As an aside, this is probably a poor example, since a good case can be made for workers' compensation benefits to be made taxable [Courchene, 1994b: 329-30].) But the point is a general one - there are numerous compromises built into the current Tax Collection Agreements that Ottawa may want to rethink.

However, this could go both ways. Ontario could view the forthcoming Seniors Benefit as taxable income, for example. What is the rationale for levying provincial taxes against the working poor when the same level of income for seniors remains untaxed? Admittedly, this discussion is taking on dire overtones. Yet the advent of a separate Ontario PIT is such a major challenge to the status quo that one would be foolhardy to rule out some form of retaliation.

Summary

The above analysis is meant to be neither comprehensive nor exhaustive. Rather, it attempts to focus on some of the likely implications for Ontario and for the federation if Ontario follows through on its proposal to implement its own PIT. What is clear is that a separate Ontario PIT would amount to a major shock to the overall fiscal system. More subjectively, what also appears clear is that, aside from the compliance and collection costs, there are likely to be benefits to Ontario, *per se*. Less clear is whether Ontarians as Canadians would perceive themselves as being better off under a separate PIT.

While the analysis to this point has directed some attention to the implications for Ottawa, the focus has largely been Ontario centred. In the final substantive section of the paper, we reverse the focus and address the variety of ways in which Ottawa is itself rethinking and reworking the operations of the Tax Collection Agreements in response to provincial concerns generally and to Ontario's proposal in particular.

7. THE FEDERAL RESPONSE

The analysis thus far has tended to focus on ways in which the existing Tax Collection Agreements appear to be falling short in terms of provincial concerns or demands. Yet there are some intriguing counter examples where both federal-provincial cooperation and fiscal integration are being enhanced. For example, under a joint agreement, the federal government now administers the British Columbia Family Bonus, which is a provincial top-up to the federal program. Since the eligibility criteria are the same for both programs, the payments are combined and the B.C. families receive only one cheque. (The amounts paid by the federal government on behalf of British Columbia are netted against personal income tax payments to British Columbia.) A similar PIT integration is occurring with the Alberta

Employment Tax Credit. For low-income working families, this employment credit is included with the federal family benefits payments and, as in B.C., the reconciliation occurs in terms of personal income taxes owing to the province. Indeed, the Quebec PIT is evolving in a manner consistent with the federal system. Specifically, Quebec is replacing a variety of family benefits with a unified benefit not unlike Ottawa's approach to the Child Tax Benefit. The message here is that, in some areas at least, the existing TCA is proving to be quite flexible and capable of generating creative and integrative options.

While this can be viewed as an important aspect of the overall federal response to the various challenges to the TCA, the purpose of this section is to focus on two more general avenues that Ottawa is pursuing in terms of updating the TCA. The first has to do with the "administrative" response, where the major ongoing initiative is the Canada Customs and Revenue Agency (CCRA). The second is the "policy" response, where the ongoing activities tend to take the form of "closed-door" negotiations between federal and provincial executives. We shall deal with each in turn.

*The Canada Customs and Revenue Agency*⁶

In the Speech from the Throne on February 27, 1996, and in the subsequent federal budget of March 6, 1996, the federal government announced its intention to develop a national revenue collection agency. This agency (CCRA) would differ from the existing Revenue Canada in three important ways (CCRA, 8-9):

- First, the Agency would operate at arm's length from all governments, thereby making it a more attractive vehicle for the single administration of the revenues of both levels of government.
- Second, the Agency would be dedicated to providing single administration services accessible to all provinces, and the provinces would have important new tools for influencing the overall development of the Agency.
- Third, while remaining a part of the Public Service of Canada, the Agency would be permitted the flexibility that its size justifies to develop its own, tailor-made management systems.

In more detail (2-3):

The Agency would assume the existing functions of Revenue Canada. These encompass the enforcement of major statutes including the *Income Tax Act*, the *Customs Tariff*, the *Customs Act*, the *Excise Act*, the *Excise Tax Act* and the *Special Import Measures Act*. ... Revenue Canada has extensive administrative arrangements with the provinces and territories. These are the direct consequence of formal federal-provincial agreements signed by the Minister of Finance. Under the agreements, Revenue Canada collects personal income taxes for all provinces except Quebec, and corporate income taxes for all except Alberta,

Ontario and Quebec. Starting April 1, 1997, Revenue Canada will collect a harmonized sales tax for Nova Scotia, New Brunswick and Newfoundland and Labrador. It also collects sales taxes at the border for some provinces. As an administrative organization, the Canada Customs and Revenue Agency would continue to collect taxes on behalf of the provinces under the terms of the existing tax collection agreement.

The governance of the CCRA would comprise a board of directors with fifteen members including the chair and the president. The chair would serve for a term of up to five years, and directors would serve for up to three years and could be renewed. With the exception of the president, all directors would be part time.

In terms of the role and extent of provincial participation in this Agency, the CCRA progress report notes as follows (p. 6):

Building on the extensive existing arrangements between the federal government and provincial governments, the Agency would promote a closer partnership with provinces in revenue administration. Where national guidelines regarding fairness and economic mobility can be met, the Agency would undertake the administration of provincial taxes at provincial request.

Provincial involvement in the affairs of the Agency would be encouraged through a variety of mechanisms. At the level of Ministers, the Minister of Finance would ensure that the Agency's progress is reviewed regularly during meetings of Ministers of Finance. The provinces would each be invited to nominate a member of the Board of Directors. The board would be consulted on the appointment of the President. A Council on Tax Administration would be established by Parliament to advise the Board and the President on matters related to provincial revenue administration. The members of the Council would be appointed by the provinces and territories, and the President would meet with the Council annually. The Council would establish liaison committees to ensure smooth working relations between the Agency and each jurisdiction for which it is providing revenue administration and related services.

The President would offer to meet annually with each provincial Minister of Finance (or their representative) where the Agency is administering a tax or program under contract or under a federal-provincial tax collection agreement. This would take the form of an accountability session, where each party could review matters relevant to the administration of the province's taxes or programs by the Agency, and areas for improvement or extensions of service could be discussed.

It is crucially important to recognize that the CCRA is an *administrative agency, not a policy agenda*:

Tax policy is determined by the Minister of Finance. The statutory duties of the Minister of National Revenue are largely administrative and adjudicative. Under the Canada Customs and Revenue Agency most of these duties would be transferred to the President of the Agency. The Minister of Finance will continue to

make tax policy, but its administration would formally and legally be in the hands of an arm's length Agency.

Informed sources indicated that the legislation pursuant to the CCRA proposal would be introduced in Parliament in December of 1997 (although this has now been delayed). It now appears that this legislation will be cast to a greater degree than suggested in the above quotations in the direction of ensuring that the CCRA is only an administrative agency.

While the CCRA is a most welcome initiative, one which has its roots in the recommendations of the Carter Commission and which mirrors similar legislation in other countries including Australia, New Zealand, and the United Kingdom, it is *not* a policy vehicle. As such, it does not come to grips with the thrust of Finance Minister Ernie Eves's earlier enunciated concerns.

But there is also considerable federal movement in the tax policy front.

Potential Changes to the Tax Collection Agreements (TCA)

While there appears to be substantial ongoing federal-provincial negotiations with respect to potential changes in the operations of the TCA (both in policy terms and how the TCA would be integrated into the CCRA), most of these have been of the behind-closed-doors "executive federalism" variety and, therefore, out of the public eye. What follows is gleaned from discussion with various participating officials although, by design, none of these is from Ontario.

In terms of Minister Eves's request to have a "simple check-off box on page 4 of the income tax return that would easily allow taxpayers to donate tax refunds to reduce the debt of the province," this check-off box will now appear on page 4 for the taxation year 1998. Apparently the delay had to do with the fact that space constraints dictated that the check-off box could not be accommodated while at the same time leaving page 4 "readable." As a result of Revenue Canada's periodic redesign of the overall tax form, the Ontario request can and will now be accommodated, from 1998 onward.

However, Ottawa *has* turned down Minister Eves's request for a tax credit for charitable donation status for gifts to Ontario crown corporations. The reason is that implementing this proposed tax credit would require administering two different tax bases, one federal and the other provincial, which in turn would run afoul of the earlier enunciated MacEachen guidelines for tax credits.

Another of Minister Eves's articulated concerns is that as a result of the timing of PIT payments to Ontario and because Ottawa retains fines, interest, and penalties on Ontario tax owing, the TCA is costing Ontario roughly \$100 million per year. The first point to note in this connection is that this is a long-standing issue. When Ontario Treasurer Frank Miller commissioned the OEC to undertake the PIT reference in 1983, this was one of his (and

Ontario's) concerns. In roughly the same time frame, B.C. Finance Minister Hugh Curtis (1981) made essentially the same claim. What the OEC pointed out (1983: 123) was that while Ottawa does retain the fines, interest, and penalties on Ontario tax owing, it also assumes the responsibility for "bad debts" on Ontario tax owing – these amounted to \$77 million for 1983. Overall, the OEC expressed the view that in terms of this general issue, Ontario was, in the time frame of the early 1980s, probably benefiting financially from the operations of the TCA.

The second point is probably more relevant. The *administration* of the provincial component of the PIT system should be revenue neutral. And we believe that this is the federal government's position as well. Apparently, a study commissioned in 1988 indicated that the TCA system was not run to Ottawa's benefit. Nonetheless, Minister Eves's new concerns (and the concerns of some other provinces), especially about the timing of payments, need to be taken seriously. As we understand the situation, the federal government is conducting further research and if this reveals a bias against the provinces, then the situation will be rectified. Note that these issues will likely be able to be sorted out much more easily and quickly if and when the arm's-length CCRA sees the light of legislative day.

The final and most high-profile and high-priority of Ontario's concerns with respect to the operations of the tax credit system is that Ottawa did not agree to collect the Fair Share Health Care Levy as originally proposed which, to recall, was a progressive tax on income. However, Ottawa did agree to administer an (admittedly rather complicated) FSHCL surcharge. Presumably, the problem from Ontario's perspective is that Ottawa continues to allow the three prairie provinces to levy "flat taxes" against taxable income. Why cannot the TCA accommodate a progressive FSHCL against taxable income? Now that we have broached the issue of tax on tax vs tax on base (or tax on income), we address the issue in more detail.

Tax on Base/Income

In the view of some officials, Ottawa and the provinces (in the context of the Federal-Provincial Committee on Taxation) were fairly close to agreeing on a tax-on-base proposal in 1994. Apparently, the potential agreement came unstuck because, among other issues, the proposal on the table required all provinces (except Quebec) to agree to a common approach to a tax on base. It is our information that this issue is again on the table, with the important difference that asymmetric approaches are no longer ruled out. Presumably this means that some provinces can continue to adhere to the current system while others can opt for rate and bracket freedom, including some flexibility in terms of how many brackets they wish to implement.

What appears to be emerging as a serious proposal is a rather flexible tax-on-base approach. Provinces would have the freedom to mount a rather flexible tax on base against the common tax base. This could encompass up to five provincial tax brackets plus some low-income credits and high-

income surtaxes. While the resulting seven or so provincial tax brackets would still not accommodate Ontario's original proposal for its Fair Share Health Care Levy (which has more than a dozen "step" increases), it would go a very substantial distance in enhancing provinces' control over the income-distributional implications of their own portion of the PIT. Provinces would have the freedom to apply their own tax rate to the block of refundable credits.

In terms of the schema in Table 1 above, row 5 would now be calculated by applying provincial rate and bracket structures to the commonly determined "taxable income" (calculated in row 2). This would generate what might be called "gross provincial tax revenue." To get basic provincial tax, one would need to deduct "provincial refundable tax credits," namely the provincial equivalent of row 4 of Table 1. Presumably the provinces would be free to apply their own tax rate to these refundable credits in order to determine the value of these refundable credits. Indeed, it might even be possible, policywise and administratively, for provinces to have a somewhat different bundle of refundable tax credits.

In other words, entries 3 and 4 of Table 1, which generate "basic federal tax," would be replicated at the provincial level in order to obtain "basic provincial tax." From basic provincial tax, one would deduct the various credits/surcharges to generate net provincial tax (as in row 7 of Table 1). Hence, both Ottawa and the provinces would utilize fully comparable approaches to assessing taxes owing in their respective jurisdictions. Moreover, as I understand the emerging scenario, provinces would also have the option of retaining the status quo.

Were a proposal of this sort to be agreed upon by federal and provincial officials and to be given an imprimatur by federal and provincial finance ministers, the TCA would evolve into a highly flexible tax-on-base or tax-on-income approach to the shared PIT.

So far, so good. But there is another feature that is apparently surfacing (or resurfacing) as a problem, namely who will decide upon whether provincial tax credits ought to be administered. I shall propose a solution in the concluding section of the paper. For present purposes, I want to make a case that the enhanced provincial flexibility, as reflected in the tax-on-income approach, not go so far as to unwind the economic union feature of the MacEachen Guidelines for tax credits. This is a lot more complicated in 1997 than it was when these guidelines were first enunciated. In large measure, this is due to the fact that many provinces want their tax systems to be harmonized with those of their competitors who, by and large, are south of the border.

Thus, the first observation in this context is that the notion of what constitutes an appropriate "internal" economic union cannot be decided in isolation from the fact that the provincial trading systems are increasingly cross-border in nature. In turn, this suggests that an appropriate criterion for tax credits be that they are non-discriminatory in terms of out-of-province residents. Phrased differently, they should satisfy a "provincial treatment"

test, in the same way as the FTA requires a "national treatment" test. At one level, this may appear to be clear – a province should not be allowed, for example, to privilege its province-based companies with incentives that are not available to non-province-based companies operating in the jurisdiction. At another level, however, the line between provincial treatment and discrimination is very fuzzy. Moreover, even if provinces are restricted from imposing discriminatory tax credits within the new tax-on-base approach to the TCA, there are plenty of other policy avenues for them to do so.

This leads to the second observation – the federation is in dire need of a "code of fiscal conduct" or a set of economic union principles that one can fall back upon in order to ascertain whether tax credit X or policy Y is consistent with the internal economic union. The entire tax area was exempt from the 1994 Agreement on Internal Trade. The time has come to rectify this omission (and proposals will be detailed later).

Without such a set of principles in place, the MacEachen Guidelines are likely to come to be increasingly interpreted in terms of "administrative feasibility" – allow all tax credits that can be administered. This would be an enormous backward step in terms of the TCA. If the provinces can mount all tax credits, provided only that they are administratively feasible, *then so can Ottawa*. This would amount to a Pyrrhic victory for Ontario, since part of its rationale for wanting more tax room is to respond to perceived discrimination from the federal government. Indeed, this would also represent a Pyrrhic victory even if Ontario were to opt for its own PIT.

While a tax on base is welcome and long overdue, it should not come at the expense of maintaining the internal fiscal union. As important, opting for one's own, separate, PIT should not be viewed as a vehicle for fragmenting the fiscal union. Both of these concerns speak to the need for some new institutional machinery dedicated to designing and implementing a national (federal-provincial) code of fiscal conduct.

While I shall address this shortly, the main conclusion of the present section is that on several critical fronts the federal government is finally taking the provinces' long-standing TCA concerns seriously. More to the point, there now appears to be a window of opportunity for a win-win compromise. The purpose of the concluding section is, *inter alia*, to elaborate on this emerging compromise.

7. CONCLUSION

By way of concluding this analysis we reproduce the three scenarios that the Ontario Economic Council report (1983: 162) suggested might lead to Ontario adopting its own PIT:

- 1 Ontario opts for a separate PIT because it is convinced that it represents an important new set of policy instruments with which to achieve the province's goals.
- 2 Ontario opts for a PIT as a defensive reaction to overall federal tax poli-

cies which are deemed to be prejudicial to Ontario interests and therefore should not be magnified by binding the Ontario portion of the PIT.

- 3 Ontario opts for a PIT as a defensive reaction to the separate PITs of other provinces or as a defensive reaction to province-building policies enacted by other provinces.

Scenario 3

The first rationale under scenario 3 is probably less likely in the current context than it was in the early 1980s when Alberta, for example, was at loggerheads with Ottawa over the NEP. Indeed, the more likely scenario is that Alberta would attempt to become associated with any Ontario move in the direction of a separate PIT. However, the second rationale under scenario 3 – a defensive reaction to province-building policies enacted by other provinces – remains a possibility. This best exemplar here is British Columbia's anger at New Brunswick's subsidization policies which led to the transfer of significant activities of United Parcel Service (UPS) from B.C. to New Brunswick. Not to put too fine a point on it, B.C. is losing its patience with transferring its tax dollars, via Ottawa, to other provinces and then having some of these provinces utilize the transfers to fragment the economic union via locational subsidies, especially in light of the 1994 Agreement on Internal Trade. New Brunswick's response, technically correct, is that the UPS deal occurred before the AIT came into effect. However, a separate B.C. PIT is probably not the best way to ensure that all provinces adhere to a level playing field. As already alluded to, this is best addressed via some version of a binding code of fiscal conduct. In any event, our overall view is that option 3 does not rank high in terms of likely scenarios that would precipitate an Ontario PIT.

Scenario 2: Towards a New TCA

In contrast, scenario 2 was front and centre in terms of Finance Minister Eves's case for an Ontario PIT. Intriguingly, it is with respect to this scenario that quite dramatic compromise appears to be possible. Drawing selectively from the above analysis, it appears that the following option could soon be on the negotiating table. Perhaps this should be rephrased: the following annotated option should be on the table.

First, tax on base is long overdue. Ottawa should offer the provinces the flexibility to levy their own rate and bracket structures against taxable income. Flexibility in this context means that provinces can, if they wish, employ up to, say, five tax brackets which, with low-income reductions and surcharges, effectively amounts to seven bracket structures. To be sure, this would constrain Ontario in terms of its initial proposal for the Fair Share Health Care Levy, but with the additional flexibility of mounting its own tax rates over five new bracket structures, this would seem to give the province ample flexibility. If for some reason, this still remains a sticking point, then

our preference would be for the federal government to allow complete provincial flexibility here.

Second, all PIT revenues should be collected by the proposed CCRA, structured along the lines elaborated earlier. The principles relating to the tax-on-base model should, once they are formulated and agreed upon, be turned over to the CCRA, which would oversee their administration (that is, implementation). Hence, provinces would then deal directly with the CCRA.

Third, Ottawa and the provinces should agree to a set of principles relating to the implementation of tax credits, surcharges, and the like. Note that these principles would also be binding on Ottawa since it, too, is in the tax-credit game. Once finalized, these principles could also be turned over to the CCRA for implementation. However, this is likely to be a non-starter since the CCRA will be an administrative agency, not a policy agency. Therefore, there must be a policy body to oversee these tax-credit principles. One solution would be to leave it to Finance Canada. But there is a preferred alternative, namely a federal-provincial body that would interpret the principles. At the annual premiers' conference in St. Andrews, the provinces produced what is referred to as the "mechanisms paper," namely a set of processes and decision rules to oversee initiatives in either the federal-provincial or interprovincial arenas. This set of processes could well be applied to the tax-credit issue. Indeed, it could become the platform for developing the tax-credit principles themselves. In any event, once in place, all requests for tax credits (whether from Ottawa or the provinces) would be vetted through this federal-provincial committee and, if accepted, would be turned over to the CCRA for implementation.

The fourth component would be the creation of a federal-provincial committee on the structure of the tax base. We do not believe that Ottawa would agree to the "strong" version of such a committee where the provinces would have equal say over any and all tax-base changes (see the right-hand column of row 2 of Table 5). On the other hand, unilateral and immediate federal changes in tax bases must be ruled out. Specifically, Ottawa would be required to serve notice (say three years) before introducing tax-base changes, unless there is general provincial support for change (some provincial voting/decision rules would have to be implemented). In the interim, Ottawa would be allowed to utilize the tax-credit route to implement its desired changes, since this would not alter the definition of taxable income over this interim period. Note that this tax-structure committee could incorporate the functions of the tax-credit committee alluded to under the third point. Obviously, the federal government would now be quite free to alter its own rate and bracket structure, since this does not impinge on provincial flexibility.

The fifth provision is that Ottawa and the provinces would embark on designing a "code of fiscal conduct" which would encompass more than the TCA arrangements. Ideally, this should become an amendment to the 1994 Agreement on Internal Trade.

These five provisions should constitute a compromise option that would

go a long way to assuage Ontario's (and other provinces') articulated concerns with respect to the functioning of the TCA.

However, we have one final recommendation to offer. The issues addressed by the above five provisions have been major provincial concerns at least since the 1983 OEC position paper and probably much before this. The TCA system has not been well served by bilateral federal stonewalling as various provinces have brought their concerns to the fore. If Ottawa is serious about ensuring that the TCA does not unwind, this is the time for it to act decisively. Accordingly, our final recommendation with respect to this package is that Ottawa, unilaterally, publicly and quickly, present this option to the provinces, presumably replete with a singing of the praises of the continuation of a shared federal-provincial approach to the personal income taxation system.

Scenario 1

This brings us, finally, to the first scenario or rationale for an Ontario PIT. The Section 4 analysis above did, as we interpret it, point in the direction of some appealing aspects of a separate Ontario PIT, albeit along with some costs. Some of the issues, such as the implementation of a reworked stabilization instrument, may be able to be integrated into the mandate of the tax-structure committee proposed in the context of scenario 2 above. Others, however, would require Ontario to implement its own PIT. Complicating all of this is the deep-seated Ontario perception (reflected in the views of the last three Ontario governments) that the province is facing systemic discrimination in the federation. This serves to place the PIT issue in the realm of High Politics, as it were, thereby transcending the more narrow PIT concerns. While rendering an assessment on the likely outcome here is well beyond the ability of an academic scribe, not to treat this as a potentially explosive issue in terms of the future of the TCA would be an enormous mistake on Ottawa's part. In our view, scenario 1 is the most likely candidate for triggering a separate Ontario PIT.

Conclusion

We wish to conclude on a more optimistic note by returning to the scenario 2 option for breathing new life into the operations of the TCA, namely the five-pronged proposal built around a tax on base and the introduction of the CCRA. Were the federal minister of finance to act quickly in terms of placing this offer (and option) on the table, the likelihood is that this would not only dramatically alter the policy framework and discussion with respect to personal income taxation in the federation but, as well, would provide a needed bridge to embrace a much larger discussion and debate over federal-provincial fiscal relations generally. Following on the *Report to Premiers* (1995) and the creative federal-provincial initiatives in the Child Tax Benefit area and, hopefully soon, on disability as well, Canada appears to be in the

process of rekindling the spirit of cooperative and collaborative federalism. In this context, it would be an enormous error if the system were to simply sleepwalk into the unravelling of the Tax Collection Agreements. Regardless of where and with whom Ottawa perceives the blame for the current TCA impasse to lie, our view is that the time has come for decisive federal leadership on this issue. As already implied, it may well be "too little, too late," but the federal government will at least be able to claim the high ground in terms of articulating a PIT option that breaks new ground in terms of designing a shared tax system ideally suited to a decentralized federation and at the same time (albeit belatedly) responds to provinces' legitimate concerns with respect to the operations of the PIT which, constitutionally, is also their tax.

8. POSTSCRIPT

On December 2, 1997, I delivered this paper (identical, except for minor editing) in a public lecture at the University of Alberta. Unbeknownst to those of us at the lecture, except perhaps for the Alberta Treasury people who were in attendance, much of the paper had already been overtaken by the march of events. The headlines in the Alberta papers the next morning featured Alberta Treasurer Stockwell Day's announcement that henceforth Alberta (and other provinces) would have the right under the Tax Collection Agreements to levy a tax on income. This represents a critical milestone not only in terms of the TCA but as well in the evolution of Canada's fiscal history. What is surprising is the virtual absence of any further public discussion and debate with respect to this fiscal watershed.

In terms of the implications of this shift to tax on base, two final comments appear appropriate. The first is that this makes Ontario's potential decision to opt for its own personal income tax system much more difficult. In one fell swoop, as it were, much of the benefits of opting for a separate PIT have evaporated – a tax on base will dramatically increase Ontario's PIT flexibility and in the process will address many, but not all, of the province's expressed concerns over the operations of the TCA. It may still be the case that Ontario will view this as "too little, too late," as suggested in the conclusion. But this is a much more difficult case to make now that the status quo itself has shifted in Ontario's direction. At the very least, the new tax-on-income approach merits serious consideration by the province, even if it is viewed as a stepping stone towards an eventual full-blown Ontario PIT.

The second point is more tentative. The case for a tax on base has been bandied about in the federal-provincial arena at least since the 1983 OEC report. As such, tracing its evolution to eventual fruition likewise requires a larger historical sweep than that presented above. Nonetheless, the paper may provide some insight into the constellation of forces (in terms of timing, if not in terms of isolating key policy issues) that led to Canada's adopting a tax-on-base or tax-on-income approach to the operations of our shared personal income tax system.

Notes

- 1 Perhaps the fifth, since Rae government insiders indicate that Treasurer Floyd Laughren was seriously considering a similar proposal, either in its own right or to exert pressure on Ottawa to allow Ontario to levy a "tax on base," rather than the current "tax on tax" (more on the tax-on-base vs. tax-on-tax approaches later). However, this initiative did not enter the public arena.
- 2 And with acknowledgment to OEC council member David Winch, who proposed this title for the 1983 OEC position paper.
- 3 The range of provincial credits by province appears in Table 2. Because they refer to calendar year 1995, they are a bit out of step with Ontario's current credits; for example, the Table 2 credits for Ontario do not include the more recent "Ontario co-operative education tax credit."
- 4 The Ontario Economic Council was terminated in the fall of 1985. As a result, the Council's three-volume report on whether Ontario should adopt its own PIT is no longer available. Hence the rationale for a brief summary of its findings.
- 5 See Orr (1998) for an analysis of the evolution of this EI stabilization fund.
- 6 Most of the detail in this section is taken from a Revenue Canada "Progress Report" on the CCRA (dated April 1997). Note, however: the actual CCRA legislation (Bill C-43) backtracks seriously from the "arm's-length" vision reflected in this quotation, which is based on a 1997 version of the proposed CCRA. Whether or not the legislated CCRA will be viewed by the provinces as an "independent revenue authority" is now open to question. The determining factor, in terms of independence, will be the nature of the bilateral tax collection agreements to be negotiated between Ottawa and the respective provinces.

COMMENTS ON

THOMAS COURCHENE'S PAPER

WILLIAM ROBSON

A discussion of Tom Courchene's informative and thought-provoking paper can usefully begin by recapping its key points. Courchene starts with some history of the personal income tax (PIT) in Ontario, the tax collection agreements (TCAs), and the background to Ontario's recent hints about establishing its own PIT. He then surveys the benefits and costs of a separate Ontario PIT, as seen by the Ontario Economic Council in 1983. The Council came down against a separate PIT, but supported a tax-on-base system, with a joint federal/provincial committee governing the base, and a "code of economic conduct" to forestall fiscal erosion of the economic union.

Courchene then surveys events since, highlighting federal downloading and decentralization, changes in Keynesian-style stabilization practices, and

a set of concerns around tax levels and competitiveness, as well as tax-transfer integration and personal-corporate tax integration. He also deals with the separate PIT as a bargaining strategy for Ontario in the face of Ottawa's systematic tilt against Ontario in fiscal arrangements. On balance, Courchene sees these developments as strengthening the case for an Ontario PIT.

What if Ontario did establish its own PIT? With a bit of rearrangement, Courchene has some good news and some bad news.

The good news is that a separate PIT would help Ontario integrate taxes and transfers facing working-age people and, more generally, its human-capital-oriented programs. It would also add leverage against Ottawa's discriminatory treatment and general offloading, and help Ontario respond to north-south fiscal pressures, principally tax competition from neighbouring states.

There is also bad news. Ontarians would shoulder higher administration and compliance costs. Particularly if the example spread, more interprovincial tax competition might threaten Canada's economic union. Provincial freedom to set rates and brackets would erode Ottawa's dominance in redistribution, and lessen Ottawa's capacity for Keynesian stabilization. Courchene also argues that a separate Ontario PIT could foster conflicts over taxation of benefits (such as the proposed seniors' benefit) provided by the other level of government – although it is not clear whether this is something to welcome or fear.

As for federal responses to this prospect, Courchene outlines two main options, not mutually exclusive. The proposed Canadian Customs and Revenue Agency (CCRA) might, as a joint federal-provincial agency, ease Ontario's concerns about federal administration. More substantively, TCA changes allowing the provinces to set their own brackets and rates on a common base, and widening provincial scope in setting credits, might answer Ontario's wishes for more policy autonomy. In Courchene's view, we will likely eventually see either a separate Ontario PIT, adopted for either "defensive" or (presumably) "offensive" reasons, or new TCAs featuring tax on base, and some bells and whistles addressing provincial concerns.

My view of Courchene's good and bad news is that both the pros and the cons of an Ontario PIT are easy to overstate. Since Ottawa may incline to focus on the down side, my more relaxed view suggests that work towards a separate PIT might help Ontario in negotiating with Ottawa. The potential payoffs, however, lie less in possible changes to the TCAs or the proposed CCRA, and more in greater evenhandedness in federal-provincial transfers and, more remote but highly desirable, provincial control over Employment Insurance (EI).

REASSESSING THE PROS AND CONS

Let me first try to justify this relaxed assessment of the pros and cons of an Ontario PIT.

The Pros

I agree with Courchene that its own PIT would help Ontario integrate its taxes with its transfers and, relatedly, to smooth the fiscal treatment of school-training-work transitions. I have trouble, however, with the argument that its own PIT would help Ontario much in coping with Ottawa's discriminatory treatment, downloading, or north-south pressures.

Taking discrimination first, it is true that Ottawa's fiscal treatment of Ontario approaches predation. After adjustment for imbalances between overall federal taxation and program spending, Ottawa drew almost \$13 billion annually (around 5 percent of GDP) out of Ontario over the past decade. But this plunder has everything to do with the federal tax and transfer system, and nothing, directly, to do with Ottawa's collection of PIT on Ontario's behalf. Lessening federal predation means scaling down programs that are tilted against Ontario and making federal-provincial transfers more even-handed. An Ontario PIT, by itself, does neither.

What about deficit-shifting and the vertical mismatch between big provincial program responsibilities and big federal taxing capacity? Again, who collects Ontario's PIT seems a secondary issue at most. Clearly, federal offloading requires provinces to spend less, or tax more, than otherwise. But an Ontario PIT would only help if it gave Ontario access to taxes that would raise more revenue at less economic cost than the existing setup allows, and I cannot think what those taxes might be. Ottawa imposes little constraint on the sales tax front; in fact, for Ontario to constrain itself further by harmonizing with the goods and services tax (GST) would probably yield more revenue at less economic cost. Payroll taxes are relatively undistorting but, again, are not at issue. As for PIT itself, if Ontario asked Ottawa to administer, say, a flat tax on the federal base along prairie-province lines, would Ottawa refuse? The vertical imbalance argument seems unconvincing: any province, Ontario included, can deal with it by raising taxes in the existing framework.

Further, the links between the overshadowing of east-west ties by north-south ones and a possible Ontario PIT are obscure to me. Although it is accepted wisdom that tax (and transfer) harmonization goes hand-in-hand with closer economic ties, my reading of the evidence is that harmonization and economic integration display every conceivable relationship, including none, depending on the jurisdictions and time period under scrutiny. If, alternatively, we are worried about a brain drain or movement to the underground economy, the structure of marginal tax rates matters much less than the overall tax burden, and a separate Ontario PIT would provide only limited scope for addressing these pressures.

The Cons

As for the bad news, Courchene's concerns about provincial income taxes being used for "protectionist" purposes are well founded (though Ottawa is

far from blameless when it comes to measures that fragment the economic union). But some other points against an Ontario PIT are less compelling.

First, interprovincial tax competition is not all bad. Sales taxes that vary among provinces are an accepted part of Canada's economic landscape. Why should provinces not compete for the favours of workers and investors as well as consumers? Taxes may be the price we pay for a civilized society, but better competition to keep that price down than collusion to keep it up.

Concern that provincial freedom to vary bases, rates, and brackets would deprive Ottawa of dominance on the redistributive front is only persuasive if one thinks it illegitimate for provincial populations to give effect to their differing redistributive preferences. Ottawa might claim primacy on the basis of greater competence, but evidence on that score is mixed – consider, for example, the current illogical mix of deductions and credits, the mismatch between the tax-free income guaranteed seniors and the threshold at which workers start paying tax, and the ludicrously low threshold at which taxpayers hit the top marginal rate.

There is even something to be said for governments taxing each other's benefits. The spread of "tax-free" benefits that are clawed back as incomes rise is producing terribly high effective marginal tax rates for low- and middle-income Canadians. Courchene cites the case for taxing workers' compensation benefits. Provincial taxation of the proposed seniors' benefit would reduce the effective marginal tax rates it will create, mitigating its worrying disincentives for middle-income Canadians approaching age 65 to put anything aside for retirement.

Stabilization concerns would register higher if it were clearer what Keynesian policies actually do. Once, fiscal multipliers in economic models were big; now they are small. Some models show national stabilization as superior; in others, subnational stabilization is better. Much more reliable, in my view, is the power of adept monetary policy to smooth cycles. Particularly in view of the fiscal mess that has developed at the federal level, partly from inept stabilization attempts, the prospect of Ottawa's losing some power in this area seems a minor concern.

Even administration and compliance costs have their up-side. A self-assessing PIT and GST-exclusive pricing are more burdensome than their alternatives but provide valuable transparency and signalling channels that more "efficient" options would not.

THE OPTIONS

Frustratingly, a review that plays down both the pros and cons leaves us little further ahead in deciding whether an Ontario PIT would be a good thing. The U.S. shows that, while less tax harmonization is untidy and often inconvenient, it need not be economically crippling and may actually be an advantage.

If the issue is less momentous than it appears, however, then Ottawa's exaggerated concern about it might offer Ontario leverage in confronting

Ottawa over other issues. What might we look for when the bargaining begins?

The Tax Collection Agreements

A move to tax on base is long overdue. It would allow provinces to express their different (and changing) redistributive preferences. It might allow limited responses to north-south pressures. But the above short list of defects in Ottawa's approach suggests that a move to tax on base alone would accomplish little. The definition of the base and Ottawa's own brackets are at least as important.

An additional caveat is that more collegial federal-provincial control over the base might, depending on the amending formula, freeze our current definition of taxable income. It might become harder, for example, to replace various expense-related credits with deductions, alter the inclusion rate for capital gains, or ease the double-taxation of savings. Exclusive base control by Ottawa, or by each province of its own, might be better than shared control. In any event, little in this option directly addresses Ontario's concerns about its treatment at Ottawa's hands.

More Even-handed Federal Redistribution

Linking PIT negotiations to other areas of tension between Ottawa and Queen's Park may be the most fruitful course. The persistence of Ottawa's tilt against Ontario over many decades suggests that progress towards a more even-handed stance will be hard. The constituency for large, persistent transfers away from some provinces and into others seems to have lost some of its enthusiasm over the past decade, however, so Ontario might anticipate some success, especially on two fronts.

The Canada Health and Social Transfer (CHST) is badly tilted against Ontario, thanks both to the legacy of the cap on Ontario's share of Canada Assistance Plan funds and to its allocation formula, which deducts the notional value of tax points transferred long ago by Ottawa to the provinces in arriving at the cash transfer (Boessenkool, 1996). Ontario can and should push for a quick transition to equal per capita cash payments across the country.

Second, federal-provincial transfers respond to the uneven revenue-raising capacities of the provinces, and to their uneven demands for and costs of programs, in two overlapping ways: through a plethora of grants (including the unbalanced CHST) and through formal revenue top-ups in the equalization program. As Courchene has written elsewhere (1995b), the overall impact of these uncoordinated arrangements is excessive. Ontario can and should push for a more transparent and even-handed federal response to provincial disparities.

Employment Insurance

Ottawa's stewardship of EI leaves much to be desired. Overall EI premium revenue is now more than twice the value of ordinary EI benefits (even after stretching "ordinary" to include regionally extended benefits). Part of the difference funds labour-market programs that intrude on provincial jurisdiction and covers unnecessarily high administrative costs. The rest pads Ottawa's bottom line – an unjustifiable use of a social insurance premium.

Ontario's position is particularly disadvantageous. Even if the EI Account were in annual balance, Ontarians would receive only 74 cents in benefits for every premium dollar paid – by far the lowest of any province (Canada, Human Resources Development, 1996: 11). Since this tilt is part of a cross-subsidy system that is widely seen as raising unemployment in Canada, Ontario can and should seek further reforms – including possible provincial control.

CONCLUSION

To sum up, then, the balance of pros and cons of a separate Ontario PIT is quite fine: static costs from added cost and inconvenience; dynamic benefits from interprovincial competition and innovation. Since the balance may look less favourable in federal than in provincial eyes, the threat of a separate PIT could be useful for Ontario in its ongoing quest for better treatment at Ottawa's hands. More flexible TCAs, more equitable treatment in transfers, and further EI reforms would be oblique but valuable payoffs from the pursuit of a separate PIT by Ontario.

COMMENTS ON

THOMAS COURCHENE'S PAPER

FRANCE ST-HILAIRE

The primary object of this paper by Tom Courchene is to assess the pros and cons of Ontario withdrawing from the current Tax Collection Agreements and establishing its own personal income tax (PIT) system. In the process of doing so, Courchene, in his usual thought-provoking manner, takes us on an extensive and enlightening tour of the trials and tribulations of Canadian fiscal federalism in the last decade or so. Some interesting detours are also provided along the way, including accounts of strained relations between the federal government and Queen's Park going back to the 1950s; a comparison of the Canadian and Australian federations in terms of which level of government (central versus state/province) was most affected by the fiscal fallout from the last recession; and speculation as to Ontario's own "distinct" interests in a North American economy moving towards higher levels of integration.

Certainly one of the main impressions conveyed in this paper – one that is rather astonishing for those who come from other provinces – is that apparently Ontario is “mad as ‘heck’ and is not going to take it any more!” More importantly in my view, however, this paper provides ample evidence of what can only be described as the dysfunctional state of our federal system. This diagnosis stems both from Courchene’s analysis of ongoing changes in the federal-provincial interface and their implications and from the overall subtext of the paper. The gist of the argument is that, should the federal government persist in its unwillingness to accommodate the province’s desire for greater flexibility within the context of the existing Tax Collection Agreements, there is an increasingly strong case for Ontario setting up its own PIT system. But the paper also suggests that merely by considering this option, Ontario may actually gain some leverage with the federal government and thus obtain concessions in this area and others.

Given the theme of this conference, my comments will focus mainly on the implications of Courchene’s analysis of the current state of fiscal federalism which, in my view, raise some serious concerns. I will then discuss briefly the issue of the provinces’ need for more flexibility within the Tax Collection Agreements and the potential consequences of Ontario eventually bowing out.

As Courchene correctly points out, “The pros and cons of whether Ontario ought to embark on its own personal income tax system clearly transcend procedural concerns and embrace stabilization, allocation, and distributional issues.” The paper goes over each of these issues mainly from an Ontario perspective, but it also shows how some of the measures implemented by the federal government in order to reduce its deficit have had a very destabilizing effect on an intricate and cohesive system of taxes, inter-governmental transfers and allocation of expenditure responsibilities which, while far from perfect – issues of transparency and fiscal responsibility come to mind – on the whole ensured that the federal government played a substantial stabilization and redistributive role within the federation and enabled the provinces to fulfill their responsibilities.

The list of measures in question is one we are all familiar with: the cumulative series of cuts, caps, and freezes to EPF and CAP and, ultimately, the end of cost-sharing of provincial social assistance expenditures under CAP and the replacement of both transfer programs with a significantly reduced single block fund; recent changes to the stabilization program; and the various reforms brought to Unemployment Insurance. At the end of the day, we are left with:

- a federal government that has withdrawn significantly from the financing of health, postsecondary education, and social assistance;
- a federal government that has reneged on its stabilization role in the economy and implemented policies which undermine the risk-sharing aspects of our federal system;
- provincial governments that must bear greater expenditure responsibilities

ties – for instance, they now have to deal on their own with the problems associated with the long-term unemployed – and that are more exposed than ever to the fiscal effects of future recessions;

- a context where “have” provinces, in response to previous cases of unfair treatment and added fiscal pressures, are increasingly unwilling to tolerate federal redistributive schemes of any kind.

There are two further aspects that should be emphasized here. The first is that the changes brought on are structural, that is, their effects will persist well after the federal government achieves its zero deficit objective. Second, with budgetary surpluses now within reach, the federal government seems little inclined to either return to the role of the “invisible hand” or reduce the tax room it occupies to reflect a diminished federal role in social policy. Rather, if the fall 1997 Throne Speech and Finance Minister Paul Martin’s economic update are any indication, it seems the federal government is in search of a new mission statement, one that will likely feature highly visible, direct interventions and initiatives in areas such as health, education, and child poverty, which have broad public appeal but are also of provincial jurisdiction. Ironically, the federal government may well implement some of these policies through the PIT system which, by virtue of the tax-on-tax mechanism, would mean that the provinces implicitly get to share in the cost of these federal programs.

These are some of the dysfunctional aspects I was referring to at the outset. The other part of the equation is that because there are no institutions or formal processes to deal with the newly created fiscal imbalances, provinces such as Ontario may feel they have no other recourse but to withdraw from the Tax Collection Agreements. While this might give the province greater flexibility and autonomy, it is by no means clear that it would solve the Ontario grievances identified in the paper.

What is clear is that should Ontario decide to opt out, the consequence would be a further unravelling of the system, with Alberta and B.C. probably following suit and each province setting its own PIT system according to its own priorities and possibly, in some cases, attempting to counteract the deleterious effects (as each province sees it) of federal policies. The discussion in the paper about the options Ontario might consider in that regard suggests as much, and we can only speculate on the ensuing efficiency costs.

The following statement by former deputy minister of finance, Fred Gorbet, is quoted in the paper: “From a federal perspective, the ultimate trade-off in managing this issue is not between more or less harmonization within the agreement, but rather between allowing enough flexibility to convince provincial governments that it continues to be in their interests to remain within the agreement and being so rigid that the agreement self-destructs.” Courchene’s analysis clearly shows that providing this flexibility is long overdue.

However, I would also argue that the need for flexibility now extends well beyond the scope of the Tax Collection Agreements and involves a

whole range of issues, including the division of tax room between the federal government and the provinces in light of a new fiscal balance delimiting the federal government's use of its spending power, and the need to develop new mechanisms through which the two levels of government can continue to co-manage the social union. Otherwise, we not only risk losing the significant benefits of a harmonized tax system, but the whole infrastructure of fiscal federalism may self-destruct.

As the paper suggests, there are already some bases from which to move forward. The current negotiations between the federal government and some provinces on the new Child Tax Benefit and on training; the upcoming federal-provincial meetings on the social union; the establishment of the Canada Customs and Revenue Agency – each of these represents an opportunity to create the new instruments and institutions required to bring about a renewed federal-provincial partnership. It seems to me that more efforts should be devoted to this end before the provinces consider bringing out the “heavy artillery.”

Is Decentralization Conservative? Federalism and the Contemporary Debate on the Canadian Welfare State

ALAIN NOËL

The problem of centralization is not just a problem of Quebec versus the rest of Canada. It would exist as a problem were Canada all French or all British.

Frank R. Scott, 1951¹

There is a general agreement, in the literature and in political debates on federalism and on the welfare state, around the idea that the movement towards decentralization tends to accompany and to favour conservative, less generous policy orientations, whereas centralization is more likely to be associated with progressive, more redistributive policies (Nathan and Balmaceda, 1990: 75). Following Ronald Watts, I will define decentralization as a situation where the constituent units of a federation have both a broad scope of jurisdiction and a high degree of autonomy (1996: 65).² Policies are defined as conservative when they emphasize formal freedom (individual rights) and favour market forces, and as progressive when they stress real freedom (rights but also more or less equal opportunities) and promote democratic participation and collective institutions (Van Parijs, 1995: 22; Noël, 1996: 15).

The arguments about the conservative bias of decentralization vary, but they may be grouped into six broad categories. Systemic arguments claim that in decentralized arrangements, lower-level governments are compelled by competitive pressures or by a lack of fiscal resources to "rush to the bottom" and to reduce social protection. Social forces arguments see business and conservative groups as more influential at lower levels, whereas labour and progressive social movements would be more effective at the centre. Political arguments consider that lower-level governments seek power for its own sake, have little interest in the substance of social policy, and will be encouraged by decentralization to seek even more powers. Institutional arguments propose that centralized policies are better anchored institutionally because they are more easily accountable, more associated with the unity and the legitimacy of the union, and less visible to the public.

Economic arguments stress that centralized policies can better respond to the imperatives posed by national and increasingly global market forces. Finally, philosophical arguments insist on the normative superiority of a larger, more inclusive political arrangement, able to redistribute more broadly between persons and between regions.

Most of these arguments are familiar and they appear logical and well grounded empirically. Very often, pleas for decentralization do not even contradict them; they simply marshal different reasons for decentralization, arguing for instance that decentralized arrangements are more sensitive to local conditions and preferences, that they favour participation, or that they facilitate policy innovation. Many authors, of course, support decentralization precisely because they accept the idea that it favours conservative orientations.

The theoretical and empirical foundations of this interpretation of decentralization are not, however, as solid as is often assumed. The first, and longest, part of this chapter reviews the arguments associating decentralization with conservative public policies, and points to their theoretical and empirical limitations. Like Peter Leslie (who nevertheless advocates centralization), I conclude that the effects of decentralization on the overall orientation of public policy and on interregional conflicts and accommodations remain basically uncertain (1987: 132). Reaching similar conclusions from a comparative assessment of federal institutions and social policy, Paul Pierson rejects any simple conclusion and argues instead that "we may have little alternative to the painstaking and detailed investigation of cases" (1995a: 473). Such a prudent conclusion may seem warranted by the inconclusive nature of the evidence, but it is not entirely satisfying. It leaves unquestioned an old and well-entrenched debate about the effects and the merits of various federal arrangements. It does not address, in particular, the theoretical and political implications of the dominant idea that there is indeed a conservative bias in decentralization.

In the second part of this chapter, I reconsider this old debate from a different perspective. My starting point is that, like all interesting political notions, the idea of decentralization is riddled with ambivalence. This is so because centralization and decentralization have multiple meanings. Contrary to what the traditional association of decentralization with conservative policies may suggest, there are indeed conservative and progressive arguments for *and* against both centralization and decentralization. In Canada, for instance, we may find conservative columnist Andrew Coyne agreeing with many on the left to support stronger federal powers (1997). Elsewhere, among the proponents of decentralization, we find public-choice economists like James Buchanan (1995), but also someone clearly on the left like German political scientist Claus Offe (1996: 27–29). This is the case because there are conservative and progressive arguments on both sides of the centralization/decentralization debate (Lipietz, 1996: 259). The arguments, of course, are not the same. Conservative arguments stress individual preferences and rights and seek to limit the role of politics and of gov-

ernments; progressive arguments privilege the community and promote political action, democracy, and government intervention. When conservatives favour decentralization, it is because they presume it will reduce government intervention; when progressives do so, they expect it will enhance democracy and facilitate intervention. Parallel arguments apply to centralization.

These different arguments, however, are not always equally important or forceful. Their weight is historically and spatially specific. At a given time in a given place, the left and the right tend to align behind specific arguments, usually with good political reasons. The third part of this chapter opens with this observation, and seeks to reinsert current Canadian debates about decentralization in their historical context. It argues that the Canadian left's promotion of centralization is losing touch with the current evolution of the welfare state. In Canada, as elsewhere among the member countries of the Organization for Economic Cooperation and Development (OECD), a new debate about social policies is taking shape, and this debate raises issues that are not easily captured by the conventional understanding of a centralized, universalist welfare state. Faced with new challenges, the left and the right are gradually defining new positions about a variety of questions, including the question of decentralization. This changing context, as well as the uncertainties identified in the first part, impose a reconsideration of the debate about centralization and social policies. The current context, I would argue, favours decentralization.

But how far should the welfare state be decentralized? This chapter's conclusion briefly addresses this question, to argue against any hard and fast rule on the matter. Centralization and decentralization remain, in the end, choices made by political communities, and these choices reflect various viewpoints about the community, about its political organization and about its social orientations. No specific solution ever becomes obviously preferable.

IS DECENTRALIZATION CONSERVATIVE?

Systemic Arguments

The most common, and apparently most convincing, progressive argument against decentralization is a systemic argument about the competitive logic of policy-making in a decentralized arrangement. In a recent book on American federalism, Paul Peterson expresses the idea with a law-like statement: "the smaller the territorial reach of a local government, the more open its economy and the less its capacity for redistribution" (1995: 28). Without central norms, constraints or interventions, the argument goes, lower-level governments are pitted against each other in a competition to satisfy business and attract investments and, as a consequence, they get caught in a "race to the bottom." They lower social standards to a minimum, whether or not voters or their representatives wish to do so (Pierson, 1995a: 452 and 457; Howse, 1996: 11).

This argument seems particularly powerful because it evokes systemic pressures, at play regardless of the actors' intentions. As such, it is akin to a variety of theoretical representations of cooperation and collective action, such as the realist approach in international relations, the tragedy of the commons, the prisoner's dilemma, or the logic of collective action. Like these various representations, the "race to the bottom" image offers a pessimistic assessment of the possibilities left to individual actors when there is no overarching authority. Like these parallel arguments, however, it may also fail to recognize that cooperation often emerges in decentralized settings.

Consider, first, the empirical evidence. Nowhere has the "race to the bottom" argument more plausibility and more political relevance than in the United States, a large federation with an integrated economy and, presumably, a number of states willing to limit as much as possible the development of social programs. The Aid to Families with Dependent Children (AFDC) program, in particular, often has been seen as a case where generous states were likely to become "welfare magnets" attractive to the poor, a phenomenon that in turn would trigger a "race to the bottom" among state governments (Peterson and Rom, 1990). Replaced in 1996 by the Temporary Assistance for Needy Families (TANF) program, a federal block funding grant combined with time limits and strict work requirements, AFDC entitled single-parent families (and, in some states, families where both parents were unemployed) to income support when their income and assets fell below a state's eligibility standards.

With respect to migrations induced by relatively generous benefits – the "welfare magnet" effect – the evidence is clear: poor people do not move to seek higher benefits (Hanson and Hartman, 1994; Walker, 1994; Schram and Krueger, 1994: 79; Levine and Zimmerman, 1996; Schram, Nitz and Krueger, 1998; and, for the case of California, Smolensky, Evenhouse and Reilly, 1997: 311–13). Even scholars who claimed there was such an effect now admit that there is little evidence to confirm its existence: there has been no migration driving the poor towards the more generous states (Rom, 1995; Peterson, Rom and Scheve, 1996: 3; Donahue, 1997: 133). Some advocates of centralization argue that the consequences are the same, since voters and state politicians believe these effects are real and act as if they were. Governors, argues John Donahue, "demonstrably base policy changes on the 'welfare magnet' scenario" (1997: 134; see also Reischauer and Weaver, 1995: 19; Peterson, Rom and Scheve, 1996). But this argument is contradicted by the lack of a downward convergence in benefit levels over the years. John Donahue himself recognizes that AFDC benefits did not evolve "in a common downward spiral; they varied as much among the states in 1985 as they had in 1940" (1997: 133; see also Rom, 1995: 71).³ More importantly, when it falls back on the prevalence of erroneous perceptions, the "race to the bottom" idea is no longer a strong systemic argument about objective forces, but rather a much weaker statement about mistaken beliefs and policy preferences – a very different type of explanation, which will be discussed below.

In other areas of American social policy, the "race to the bottom" scenario does not fare better. In education, for instance, a sector where the federal government has no more than a minor role, "the race has been to the top, not the bottom ... With California being the stark and sole exception, all states have spent more money on their schools," and "historically low-spending states have played catch-up, increasing their expenditures on schools even more than the average" (Rothstein, 1998: 72). This trend cannot be attributed solely to middle-class self-interest or to the economic development consequences of education since the growth in spending has particularly benefited special education for the handicapped and compensatory education for minorities and the poor (Rothstein, 1998: 72). In environmental protection, the idea of a "race to the bottom" would also be "outdated," failing to comprehend how states, businesses, and the public have changed in the last thirty years (Graham, 1998).

In Canada, the most thorough analysis of the systemic argument has been presented by Keith Banting. In *The Welfare State and Canadian Federalism*, Banting argues that, in the 1920s and 1930s, the mobility of capital and labour constrained provincial social policy initiatives and reduced "the likelihood that provincial diffusion would create as complete a system as would emerge under more centralized political arrangements" (1987: 66; see also Banting, 1998: 15).

The evidence presented by Banting, however, is rather limited. The author presents a few references demonstrating that capital "mobility was certainly a concern of provincial leaders during the 1920s and 1930s," but admits the assumed pressure "did not prevent the diffusion of Worker's Compensation, nor at a later date the establishment of health insurance in Saskatchewan" (1987: 64-66). One could argue that Workers' Compensation did not require public financing (1987: 61). But this financing issue is distinct from the mobility argument. In "The Province of Quebec at the Time of the Strike," Pierre Elliott Trudeau offered additional, telling evidence when, notwithstanding his aim to portray Quebec as lagging in every respect, he observed a very strong pattern of diffusion in provincial labour laws. Such laws should be at the forefront of a competition for mobile capital. Yet, from the nineteenth century to the Second World War, almost every innovation was diffused within a few years; as a result, "both the spirit and the letter of labour laws were the same from province to province, even in Quebec" (1974: 54-56).⁴ Different commission reports, quoted by Banting, point in conflicting directions, some stressing competition, others policy diffusion or the restraint associated with "the financial concepts of that time" (quoted in Banting 1987: 66). Overall, the demonstration is mostly about perceptions of mobility and competition, rather than about their actual presence or effects. As explained above, perceptions may be important, but they are not sufficient to confirm the existence of a systemic mechanism. They could just be erroneous. To such limited evidence, Banting adds a quotation from an economist, who asserts that rational choice theorists are "fairly certain that there would be less redistribution in total under provincial than

under federal jurisdiction," and concludes that the mobility of capital and labour would most likely have prevented provincial diffusion from producing "the same range of income security as has developed under federal jurisdiction" (66-67). The demonstration provided does not warrant such a conclusion.

Consider, now, recent trends. In contemporary Canada, social assistance has been very decentralized, more so in fact than in the United States, and differences in benefits have remained important (Boychuk, 1995: 131, and 1997: 10-12 and 26-27). Yet, there is no evidence that poor people move from one province to another to take advantage of significant differences in benefits (Boychuk, 1995: 125). Likewise, poor provinces do not seem to pursue a strategy of "competitive deregulation" and support instead the development of national social programs (Pierson, 1995a: 469). In social assistance and social services, genuine differences between provinces persist, and there is no trend toward convergence, downward or upward (Boychuk, 1995: 131).

At this point, it is interesting to bring into the discussion a somewhat different case that casts light on the reasoning behind the systemic argument. One of the main worries of Canadian opponents to North American economic integration was that it would force Canada to harmonize its social policies with those of the United States. A recent survey of the evidence finds "only limited support" for this proposition, and argues the two countries "continue to travel different paths in social policy." The author of the survey, Keith Banting, concludes that these findings provide a useful "warning against the assumption that convergence is necessarily a consequence of economic integration" (1997: 270, 274, 306 and 309). "Determinist" predictions of harmonization around a standardized model, adds Banting, exaggerate the role of economic factors and neglect the importance of domestic politics (309).

The notion of convergence presented in Banting's comparative analysis is not exactly the same as the idea of a competitive race to the bottom; two countries could remain divergent while eroding their social programs to remain competitive. Clearly, however, the convergence that worried Canadian nationalists and that did not materialize in the 1980s and early 1990s was a downward convergence driven by labour and capital mobility, in a scenario akin to the race to the bottom. Beyond the differences, this example points in the right direction when it warns us against determinist predictions about the evolution of social policies.

Like the presumption of convergence under North American free trade, the systemic, "race to the bottom" argument makes economic pressures determine policy. This interpretation leaves little room for politics, or for the diversity of the social preferences and political processes involved. In addition, as Gerard Boychuk notes, the argument assumes "that economic imperatives point clearly in a particular policy direction" (1995: 124). As such, it is akin to the conservative argument against the welfare state: social

programs are reduced to costs and constraints that hinder the functioning of markets and undermine the competitiveness of an economy. The less there are, the better. The idea that good social programs could contribute to a society's prosperity and competitiveness is precluded (Muszynski, 1994: 316–17 and 321). In a competition, those states at the bottom are the only ones that can win.

Finally, the systemic argument makes very little of a federal society. To borrow an image from Jon Elster, a country like Canada becomes a market, rather than a political forum (1986). In a federal society, however, provinces are not mere units competing to attract investments or to offload their poor. They are small societies embedded in a larger one. This implies that politics matter not only within each province but also in the broader federal society. Social policy may become an "instrument of statecraft" used by various governments to shape political communities and legitimize their power (Banting, 1995a: 271). More important, it is an integral part of an implicit "social contract" defining the larger federal society (Simeon, Hoberg and Banting, 1997: 409). Citizens and their representatives care about social policies and their outcomes, in their state or province but also beyond. When they deliberate, innovate, or resist change, they tend to pay close attention to what goes on elsewhere in the country. American welfare reforms, for instance – presumably the case most favourable to the "race to the bottom" argument – appear driven mainly by country-wide debates and trends; "in fact," concludes a recent study of the determinants of state innovations, "states appear to respond to national trends in welfare use more than they do to their own circumstances" (Shaw and Lieberman, 1996: 10–11). Welfare innovations also diffuse rapidly, largely because the debate is general, involving groups, policy organizations, experts, officials, politicians, the media, and citizens throughout the whole country (Norris and Thompson, 1995: 220).⁵

A variant of the systemic argument stresses uneven fiscal resources rather than the pressures induced by labour and capital mobility. In a decentralized arrangement, with no or insufficient fiscal equalization mechanisms, the governments of poorer areas would be unable to match the social programs of wealthier areas, unless they were willing to levy higher taxes. As a result, there would be important regional disparities in social policy and, according to Keith Banting, "on average, less comprehensive protection" (1987: 63). It is true that, in a decentralized arrangement, different governments provide different levels of social protection. Responding in various ways to distinct social preferences and situations is precisely the purpose of decentralization. The relationship between social policies and wealth, however, which is more preoccupying since it implies unequal opportunities, is not quite as obvious as it seems.

The comparative literature on the welfare state has established that, beyond a certain threshold, social policy generosity (measured by social expenditures or by various qualitative indicators) is less a function of a

country's national income than of its political life and institutions (Esping-Andersen, 1996: 6). Sweden and the Netherlands, for instance, have built more generous welfare states, with less national income, than the United States or Japan. Canada itself, of course, is less wealthy than the United States. Studies of public policies in the American states point in the same direction. In early research, the prevailing view was that economic conditions dictated policies, to the point that state politics hardly mattered (Dye, 1966: 296-97). Later studies, however, qualified this assessment and demonstrated the relevance of various social and political factors (Plotnick and Winters, 1985; Brown, 1995). This seems particularly true for redistributive policies, because they appear less influenced by state income than social and physical infrastructure expenditures (Peterson, 1995: 104; Tweedie, 1994: 664).

More fundamentally, the very idea of a causal relation between state wealth and public policies could be an illusion. When variables measuring state public opinion are included in multiple regression equations explaining state public policy orientations, socio-economic variables simply become non-significant (Erikson, Wright and McIver, 1993: 84 and 245). Oklahoma and Oregon, for instance, have very similar socio-economic profiles, but very different public policies, primarily because the former has a conservative electorate, and the latter a more liberal population (Erikson, Wright and McIver, 1993: 73-74). Among the American states, as in the OECD, wealth simply does not dictate social policies. In the case of Canada, the impact of fiscal resources on provincial policies is difficult to test because "federal transfers remove a high proportion of the original inequality in provincial access to public revenue" (Simeon, with Miller, 1980: 249). Still, for the 1956-1974 period, about half the variance in health, education, and welfare spending could not be explained by economic variables (Simeon, with Miller, 1980: 280). The activism of the Quebec government, for instance, and the conservativeness of its Ontario counterpart, probably had more to do with the policy preferences of their respective electorates than with their relative wealth (Simeon, with Miller, 1980: 279; Simeon and Blake, 1980: 92-94 and 100).

Without denying the relevance of fiscal resources, comparative research on OECD countries, on American states, and on Canadian provinces does not support the idea that relatively poor areas must necessarily adopt less generous policies. As for the thesis that lower social protection occurs in a decentralized arrangement, this rests on a number of unspecified assumptions about policy preferences, population sizes, and fiscal resources that are difficult to assess. In a paper on the "welfare magnets" notion, Russell Hanson and John Hartman argue, on the contrary, that a national social assistance standard would probably make the situation worse for the American poor, because "any standard likely to win the assent of a majority in Congress is likely to be near the median state's current standard," and well below the standards of the more liberal states, where welfare recipients are concentrated (1994: 26-27).

Social Forces Arguments

If systemic pressures do not impose a conservative drift in a decentralized polity, internal social forces may. It has often been argued that, compared to central institutions, lower-level governments advantage business and penalize labour and the poor (McRoberts, 1993: 171; Howse, 1995: 276). Many reasons are advanced to justify this argument, most of them having to do with the size of the units involved.

First, this understanding of social forces can be a variant of the systemic argument. Paul Pierson, for instance, suggests that in a decentralized system, business has "mobility options" that increase its power relative to labour and the poor (1995a: 453; see also Cairns, 1988: 109). The absence of a race to the bottom does not preclude the possibility that the threat of "exit" works, at least at the level of perceptions. There is, indeed, some evidence that governments compete against each other to attract or maintain private investments, even though the impact of this competition on investments and economic growth is far from clear (Donohue, 1997: 75-76, 94, 181; Young, Faucher and Blais, 1984: 799; Simeon and Robinson, 1990: 234-35). This, however, does not mean the situation is very different at the centre. In Canada, at least, federal policies to promote economic development have "dwarfed provincial efforts" (Young, Faucher and Blais, 1984: 798). More generally, there is little reason to believe that what Charles Lindblom has called "the privileged position of business" plays less at the centre than within the units, especially now that mobility appears less circumscribed by national borders (Lindblom, 1977; Simeon, 1994: 23, 37-38; Howse and Chandler, 1997).

A second variant of the social forces argument insists less on mobility than on the predominance of certain sectors within a smaller territorial unit. State politics, argues John Donahue, is more likely to be influenced by locally powerful industrial sectors (1997: 90). The argument is familiar in Canada. Garth Stevenson, in particular, has presented the provinces as heavily dependent on the primary and secondary industries concentrated on their territory (1977: 79; 1982: 77). Little evidence, however, confirms this point of view. As Young, Faucher and Blais note, resource industries, or for that matter any industrial sector, represent a very small share of provincial revenues and they have also benefited heavily from federal interventions (1984: 805-808). Even in western provinces heavily dependent on specific resources, provincial governments have proven to be competent and largely autonomous actors, able to impose rules on key industries and to capture rents from resource production (Richards and Pratt, 1979: 7-8). If anything, in a service economy with dense trade, investment, and corporate ties, business should militate for a more integrated economic union and, as a matter of fact, it does (Schwanen, 1996: 8-9; Fortin, 1992: 233). The 1994 Agreement on Internal Trade, which "lessens the capacity of governments, especially provincial governments, to act" was openly supported by a business community that demands even more integration (Doern and

MacDonald, 1997: 151–53). This orientation does not preclude business involvement in provincial politics. It simply suggests that there is no tight relationship between centralization or decentralization and business, or other, interests. The different actors, concludes Alan Cairns, “work the federal system” to their advantage, intervening at the most favourable level when they need to do so (1988: 110; see also Pierson, 1995a: 454).

A somewhat different way of presenting the social forces argument consists of stressing the heightened possibility of constituting particular, more narrow, regional majorities in a decentralized system. “Government on a national scale,” argues Robert Howse, “will be less susceptible to majority tyranny, precisely because national political outcomes are likely to reflect a greater diversity of opinions and interests” (1995: 275). This possibility, however, can work either way (as Howse recognizes). It is precisely because regional majorities could be constituted that Saskatchewan introduced universal hospital and medical insurance and that Quebec conceded the right to strike to public-sector workers, two progressive innovations that were later generalized (McRoberts, 1993: 172). The real threat associated with regional majorities does not derive from decentralization, but rather from intrastate federalism, the representation of such majorities within central institutions. In the United States, it was not state governments that resisted and blocked federal income transfer programs and progressive welfare reforms, but a “veto coalition” composed of business, conservative Republicans, and southern Democrats. Southern Democrats, in particular, played a critical blocking role in Congress (Pierson, 1995b: 303–306, 327; King, 1995a: 13–14, 162–63, 210–211; King, 1996).⁶ In Canada, intrastate federalism is weakly developed (McRoberts, 1993: 153). If the Reform Party’s project of an effective Senate prevailed, the political power of conservative regional majorities would increase seriously, and the country would probably become more conservative. But it would also be more, not less, centralized.

A final version of the social forces argument deserves mention, less because it is credible than because it is ubiquitous, although usually implicit. Daniel Latouche puts it nicely in his essay for the Macdonald Commission: “to a liberal-minded intellectual in English Canada, it is apparently impossible for anyone who operates in a provincial setting to take a progressive attitude to social issues or to have respect for civil liberties and concern for justice and equal opportunity.” “Of course,” adds Latouche, all “have honeyed and deferential words for local democracy, and control by the grassroots, and respect for regional characteristics, but there could never be a question of putting this local practice into a permanent political structure” (1986: 111). Replying to this argument is tricky because it is usually implicit. Robert Howse, however, presents it in a fairly straightforward way, when he explains that “in smaller and more homogeneous communities, the contest between opposing ideas and interests may be much less vigorous, thereby resulting in a more impoverished process of democratic debate and deliberation” (1995: 275).⁷ The problem with this argument is that Canadian provinces and American states are not small, homogeneous communities.

Decentralizing policies to California, observe Neil and Barbara Gilbert, means shifting responsibilities to a state that "is three times as large as England geographically and has twice the population of Sweden" (1989: 22). One could argue that political participation is lower in American state politics than in national elections (Howse, 1995: 277). A good case can be made, however, that political debates within states remain meaningful (Erikson, Wright and McIver, 1993: 244-53). Many American activists are beginning to look again at the states, where large lobbies seem less powerful and innovation easier to achieve (Berke, 1997; Schram and Weissert, 1997: 2). In any case, in Canada, participation is higher in Quebec politics than in federal politics. The general point is that, beyond truly small communities which the provinces and states are not, there is no obvious relationship between size and the quality of democratic life.

Political Arguments

The political arguments considered here associate intergovernmental political conflicts with conservatism. The basic idea is that politicians and bureaucrats at all levels of government seek to preserve and "enlarge the scope of their functions" (Cairns, 1988: 105). "Federal and provincial governments," writes Alan Cairns, "are not neutral containers or reflecting mirrors, but aggressive actors steadily extending their tentacles of control, regulation, and manipulation into society" (1988: 107). Power is sought for its own sake, even when the clash of interests risks generating complex and contradictory policies (107 and 117). Cooperative and progressive solutions are hard to obtain for two reasons. First, when a government establishes its predominance in a policy field, it occupies (or pre-empts) the field and makes major reforms difficult (Pierson, 1995a: 456). Second, in such intergovernmental conflicts, governments care less about the substance of policy than about the division of powers, and they are unlikely to yield for the sake of better policies (Banting, 1987: 122, 138-39, 143-44, 172-73).

Whether or not this point of view has empirical value, it is more an argument about federalism than about decentralization. The characteristics attributed to governments are indeed shared equally by all levels of government, and the problems associated with intergovernmental conflicts are roughly the same in more or less centralized arrangements. In Canada, for instance, it was the federal government that pre-empted most of the social policy field, because it "established a strong social role when the provinces were politically and financially weak" (Banting, 1995a: 298). As a result, it probably prevents progressive reforms some provinces would wish to pursue, as is currently the case with Quebec's family policy (Noël, 1998: 262-63). This, however, is a problem of centralization, not decentralization.

In addition, the conflictual nature of intergovernmental relations and the presumed disregard of governments for the substance of policy are probably exaggerated. The recent cooperative efforts of the provinces and the federal government on internal trade, on manpower training, on social policy, and

on constitutional matters indicate that not all is conflict in intergovernmental relations. As for the argument that provinces disregard the substance of policy, this presumes that the different actors broadly agree on the core issues. Keith Banting, who claims this is the case, acknowledges however that significant differences remain which separate the citizens and elites of the various Canadian provinces (1987: 143, 163). Banting seems to consider these differences trivial when he justifies centralization, and worrisome when he ponders the possible consequences of decentralization (compare 1987: 139 and 163). I would argue that differences, even minor, do actually matter; in social policy, in particular, "the devil is in the details" (Osberg, 1994: 57, 62).

A related political argument sees in any decentralization a first step on a slippery slope towards further decentralization and eventually disintegration (Banting, 1987: 179). If intergovernmental relations were a purely conflictual, zero-sum game, this expectation could make sense. When the possibility of cooperation is accepted, however, it appears more dubious (Young, Faucher and Blais, 1984: 808–812). In any case, this slippery-slope argument is really an argument about unity, not about conservatism. I will address the unity question more specifically in the next section.

Institutional Arguments

Three institutional arguments against decentralization need to be addressed. This can be done briefly since, once again, these are more arguments about institutional preferences than about conservative or progressive policy orientations.

The first argument concerns accountability. Assuming decentralized policies would still be financed by federal revenues, Robert Howse argues there is "a significant moral hazard ... with respect to federal sub-units spending money that has been raised by the national government," because "sub-unit governments are not fully accountable" for funds they did not raise (1995: 283; 1996: 12, 14). Andrew Coyne goes further, and enunciates "Coyne's Law," which states that "the closer the government, the less accountable it is" (1997: 21). I will only discuss Howse's point.

Consider employment insurance. In 1994, the Canadian Institute of Actuaries proposed the creation of a distinct account for unemployment insurance revenues and expenditures, arguing that the confusion in general revenues and expenditures of funds entirely contributed by employers and workers was not a sound accounting practice (Bloc québécois, 1995: 272). The suggestion, of course, was not followed. While motives should not be imputed, it is obviously convenient for the federal government to include employment insurance revenues in the general budget, and use a good portion of these revenues for other purposes (the federal government withdraws more than \$5 billion per year, out of total employment insurance revenues of about \$19 billion [Vaillancourt, 1997: 49]). One can hardly say, however, that this practice makes employment insurance "accountable in terms of

the actual results achieved" (Howse, 1996: 12). But this is not the end of the story. When the federal government accepted to transfer to the provinces some of the active labour market measures associated with employment insurance, it imposed a series of limitations and controls, presumably to maintain accountability. Money that was not accountable in terms of results in Ottawa, somehow became "a significant moral hazard" when spent by the provinces. With respect to the "actual results," the restrictions imposed by the federal government were not even helpful. The very purpose of transferring these activities to the provinces was to integrate the labour market programs available to different categories of unemployed (Bouchard, Labrie and Noël, 1996: 88-91). "Training," noted Thomas Courchene, "should not be the privilege of the UI beneficiaries at the expense, say, of those on welfare" (1994: 286). Such a privilege is precisely what the new agreements impose, in the name of accountability (Human Resources Development Canada, 1997). According to André Burelle, everything would have been clearer if the provinces had been transferred the revenues, through tax points, as well as the expenses (1997). The general point is that central policies are not, in essence, more accountable than provincial ones (for other examples, see Young, Faucher and Blais, 1984: 812-13; Richards, 1996: 4; Boessenkool, 1996: 17). Federalism creates special difficulties in this respect, but they occur at every level of centralization or decentralization.

As mentioned above, decentralization can also be presented as a threat to national unity, especially for a divided country like Canada (Banting, 1987: 165-67, 177; Morris and Changfoot, 1996; Whitaker, 1997: 58). While this argument is not really related to conservatism, it is an important one, about which a few words should be said. One answer would be to deride a unity strategy that relies so much on central government spending (see Marcel Côté, quoted in Courchene, 1995a: 52). This reply is unfair because social policy involves much more than spending; it uses political power to institutionalize values deemed important to a society (Marshall, 1975: 15). These values, however, are associated with the programs, not the providers. What helps define Canada as a community is universal health insurance, not the Canada Health Act, or social assistance for all in need rather than the Canada Assistance Plan or the Canadian Health and Social Transfer (programs that hardly anybody knows). Ottawa, explains Courchene, can mostly deliver "thou shall nots" or "negative integration"; the provinces should provide "positive integration" (1995a: 61; 1996). They already do. It is the provinces, for example, that decide who is a person in need and define most of the content of Canadian social assistance (Boychuk, 1996: 16). Universal health insurance was also a creation of the provinces, which introduced it and gave it a substantive content (Courchene, 1994a: 174-81). "In the absence of national minimum standards," writes Carolyn Tuohy, "the broad popularity of medicare together with the interests of powerful provider groups are likely to operate in favour of the continuation of a generous program" (1993: 301). If social policy holds Canadians together, it must be admitted that the provinces have much to do with it. Provincial govern-

ments are also Canadian governments.

A third institutional argument claims that redistribution works best when it is hidden. "In comparison to the political certainty of the transfers hidden in the federal income security programs," argues Keith Banting, "decentralization plus equalization would be a high-risk strategy for poorer regions" (1987: 164). The major restrictions to social transfers and to employment insurance implemented in the mid-1990s, combined with the relative stability of equalization payments, cast some doubts about the "political certainty" of transfers hidden in income security programs (Phillips, 1995: 69; St-Hilaire, 1996: 28; Bickerton, 1996: 21). In fact, straightforward equalization payments may be easier to defend than hidden equalization mechanisms which tend to raise doubts about the fairness of any given social policy (Courchene, 1995b: 55). One should also keep in mind that hidden transfers also facilitated, in the 1980s, welfare state retrenchment "by stealth" (Rice and Prince, 1993). The idea that hidden transfers are more sustainable is associated with a general presumption that Canadians are less generous than their elites, so that there would not be as strong a social union if citizens were given full information and the power to decide. This mistrust of democracy underlies much of the progressive argument against decentralization. I will come back to this broader question below.

A variant of the argument on redistribution suggests that, by loosening the bonds of the union, decentralization would undermine public support for equalization. While this may be the case at a very high level of decentralization, there is no simple relationship between centralization and redistribution. The need for equalization is, in fact, a product of decentralization, and some fairly decentralized federations like Canada remain strongly committed to the reduction of regional disparities. In Germany and Australia, this commitment is even stronger, whereas it is almost non-existent in the United States (Watts, 1996: 47). Overall, these variations seem more related to a country's orientation towards redistribution than to the centralized or decentralized character of its federal system. (For an overview of how countries vary in their support for redistribution, see Noël and Thérien, 1995.)

Economic Arguments

Some arguments against decentralization are cast in technical or efficiency terms. Economic imperatives would sustain a need for centralization. In the 1960s, decentralization was accused of distorting Keynesian fiscal and monetary policies, of misallocating resources in economic development efforts, and of fostering inequality (see Simeon and Robinson, 1990: 210). Nowadays, decentralization undermines efforts to build a competitive economy for the new global economy. "Economic success," writes Roger Gibbins, "seems to be coupled with relatively strong national governments (albeit governments that themselves are constrained by new global realities) and with relatively centralized federations" (1997: 21). These assertions

appear to clash with the often repeated political claims that Canada is the most decentralized federation in the world and an economic success story. In any case, such broad evaluations are very difficult to assess and the opposite argument, that nowadays economic success requires decentralization, can be made convincingly. Tom Courchene, in particular, has discussed extensively the fact that comparative advantage is increasingly a regional phenomenon and the importance, in this respect, of what he calls "untraded interdependencies" (Courchene, 1995a: 30-31). The recent transformation of the New Brunswick economy probably has more to do with provincial policies and interventions than with a "strong national government," and the same is true, I would argue, for the earlier evolution of Quebec's economy (Noël, 1993).

The economic imperatives argument can also be more specific. It is often said, for instance, that the decentralization of labour market policies erodes "the government's overall capacity to manage a national labour-market strategy and, for that matter, the Canadian economic union" (Bakvis, 1996: 155; Burton, 1996; Gibbins, 1997: 7-8). The development of active measures, deplores one commentator, "now remains contingent on provincial inclinations" (Stoyko, 1997: 104). In this case, at least, the argument seems moot. The labour market in Canada is local, regional, and provincial, and it is primarily at the local and provincial levels that the concertation necessary for active labour market measures can take place effectively. The call for a "national" policy only makes sense if we assume that anything we deem important becomes a "national" issue. In the labour-market case, decentralization is necessary to promote effective and progressive social policies (Noël, 1998: 262).

The more general economic or efficiency argument I wish to present has to do with the proper balance between market integration and state autonomy. Given the market pressures brought by economic integration, explains Fritz Scharpf in an article on European welfare states, constraints emerge for national states that could erode existing social policies. These policies, however, are still popular and well entrenched, and what matters most is to preserve the capacity of each state to maintain them and innovate, against the temptation to establish uniform rules that are more likely to be driven by market integration than by social imperatives (1997; Streeck, 1995: 393-98). This situation, I would argue, is not far from the Canadian one. For Canada, the most problematic scenario is not a race to the bottom between the provinces or between Canada and the United States, but rather an erosion of the provinces' capacity to sustain original social policies and social contracts (Robinson, 1995: 251). The adequate response to such a challenge will not come from national standards, but rather from the protection and promotion of the autonomous capacity of each province to maintain social programs, foster existing social contracts, and introduce innovative social policies.

Philosophical Arguments

A final set of progressive arguments against decentralization contends that a broader, more inclusive, redistribution arrangement is intrinsically superior to a narrower, local alternative. Rarely presented in Canada, this argument has been made most convincingly by the Belgian philosopher Philippe Van Parijs, who argues that "progress consists in gradually extending the type of solidarity between persons exemplified by our social security system, to persons who belong to an ever-increasing number of human communities" (Van Parijs, 1993: 60, my translation). I have discussed elsewhere the limitations of this viewpoint, which reduces justice to its redistributive dimension and does not pay sufficient attention to the concrete political conditions under which progressive policies can be achieved. It is not obvious, for instance, that a large redistributive entity like the United States comes closer to an ideal of justice than a much smaller one like Norway. The argument nevertheless has force, and reminds us of the importance of maintaining redistribution within a federation, and beyond (Noël, 1998: 253-54).

Conclusion

Among the arguments associating decentralization with conservativeness, the most common and, apparently, the most convincing is the systemic argument. We have seen above that there is little empirical evidence that a race to the bottom is taking place, even in American social assistance. In fact, in the United States, the "bottom" was reached in Washington, D.C., with the adoption in the summer of 1996 of the Personal Responsibility and Work Opportunity Reconciliation Act, a federal law that ends a sixty-year-old entitlement and terminates any federal help for a family that goes beyond a five-year time limit on welfare, even if it "has done everything that was asked of it and even if it is still needy" (Edelman, 1997: 45; Bloom, 1997).⁸ Beyond the evidence, which can always be challenged, it was also argued that the systemic argument leaves little room for politics, assumes economic circumstances dictate unique and optimal policy solutions, and denies the existence of a federal society that would be more than a market. Arguments about social forces appear equally unconvincing. There is no evidence that business is more powerful, or labour and social movements less, at lower levels of government or in areas with smaller populations. Theoretically, it is also hard to sustain an argument about size, when the units involved are equal or larger than many democratic countries.

Many other arguments are only indirectly related to conservatism and appear, in any case, dubious. The idea that lower-level governments have little interest in social policy and only seek to expand their power, for instance, misrepresents the importance of details and of implementation in social policy. If it were true, the argument would apply equally to all levels of government, in more or less centralized settings. The same holds for accountability problems, which are problems of federalism, not of decen-

tralization. There is also no evidence that values uniting citizens can only be promoted by central governments, that hidden transfers are more resilient politically, or that centralization is needed to build a competitive economy and a generous welfare state. Finally, philosophically, a broader-based redistribution system is not necessarily preferable.

If we accept these different counter-arguments as true, there is no political, technical or philosophical impediment to decentralization. Another argument, however, can be put forward: What if a strong central government is needed to define common values and objectives above the heads, so to speak, of citizens, interest groups, and lower-level governments? In a comparative context, the argument may appear somewhat unusual, at least in such an explicit fashion. It is, however, a very important idea in Canadian political life, particularly on the left. The next section introduces this idea and discusses it in the broader context of contemporary debates about centralization and decentralization.

DECENTRALIZATION, LEFT AND RIGHT

"The real issue facing federal policy makers," wrote Keith Banting in the summer of 1994, "is whether they can generate a 'people's package' that can be used to rally public support against the probable objections of at least some provinces and most social groups" (1994: 66). For Banting, it was incumbent upon the federal government to define and articulate a social vision for Canada, one that would appeal to citizens but would not emerge autonomously from their debates. This prescription appears to be based on the perception, widely shared in Ottawa, that there is "a considerable gap ... between the advocacy voices ... and the preferences of the wider public as measured by opinion polls" (Banting, 1995b: 288; see also Jenson and Phillips, 1996: 123-26). Something deeper is also at play, however. At the outset, Canadian social policies were understood as a way of shaping a new "national" identity, in a divided country. This new identity, which constituted Canadians as individuals endowed with common rights, "was sponsored by the Liberals, supported by the Tories, and claimed as a victory by the CCF" (Jenson, 1995: 107-108). The Canadian left, in particular, pressed the creation by the federal government of "a national community whose social agenda and Constitution should be responsive to the will of a national majority, unimpeded by governments based on recalcitrant local majorities" (Russell, 1993: 62). The role of the state was not to respond to, but rather to shape public demands and expectations, and beyond that to shape the public itself.

This viewpoint responded to the fragmented nature of Canadian society, but it was not uniquely Canadian. Everywhere, the social-democratic and liberal left was tempted by the idea of running ahead of civil society to establish new citizenship rights. Localism and traditional identities were distrusted, and the central state was seen as the engine of modernity (Wolfe, 1989: 128; Simeon and Robinson, 1990: 121-22).

This understanding of the role of the state is still very present in the Canadian left, and the state is expected to create a national consensus even when there are no public foundations for such a consensus (see, for instance, Cohn, 1996: 169, 180). Hence, the preference for hidden transfers, unilateral actions, and "people's packages." This perspective on welfare politics does not, however, encompass the entire tradition of the left, in Canada or in comparable societies. From its early struggles over civil rights and universal suffrage, the purpose of the left has always encompassed more than state intervention or income redistribution. First and foremost, the left fought for the promotion of what Philippe Van Parijs calls real freedom – in contrast to formal freedom (1991: 225). The aim was to fully realize the democratic promises of liberalism, notably by giving persons the means, as well as the right, to be free. During the 1945–75 period, this objective was pursued largely through the construction of the welfare state. As a result, the left came to be associated with the promotion of government intervention, to the point where its fundamental concern with freedom and democratic practices was sometimes neglected or forgotten (Noël, 1996: 14). As a new era of debates opens, this preoccupation is coming back to the forefront, and conflicts over redistribution are increasingly redefined as conflicts "over the democratic procedures according to which the resources are allocated" (Kitschelt, 1994: 6).

This preoccupation with real freedom and democracy explains why there is a decentralist tradition on the left, just as there are also both centralist and decentralist traditions on the right. In nineteenth-century Canada, notes Peter Russell, centralism "was primarily a Conservative cause" (1993: 62). John A. Macdonald wanted a strong central government rather impervious to democratic impulses, and popular challenges came largely from the regions (Whitaker, 1992: 217–18; Simeon and Robinson, 1990: 42–43).

For the left, decentralization is valuable insofar as it helps communities, enhances democratic practices, and promotes political action; centralization, on the other hand, is sought when it facilitates the promotion of state intervention and equality. On the right, centralization is desired insofar as it helps create and integrate markets, whereas decentralization appears primarily as a means to reduce government intervention. The left wishes to decentralize towards communities, the right towards the market.

These ambivalent orientations indicate a much more complex debate than what is implied by the idea that decentralization favours conservative policies, an evaluation that is closely associated with the welfare state of the 1945–75 period. The terms of the debate about the welfare state are now changing, and so are the attitudes both of the left and of the right towards decentralization.

TRANSFORMING THE WELFARE STATE

Between 1945 and 1975, the social-democratic idea of the welfare state was hegemonic; it dominated, as the society-wide project around which debates,

reform proposals, and reactions were framed. The conservative idea of society had not disappeared but, to a large extent, it was reactive, fighting what appeared as a rearguard struggle. In Canada, for instance, the initial opposition to federal welfare state initiatives was largely a defensive affirmation of provincial prerogatives and of the status quo (Vaillancourt, 1988: 119).

At the same time, on the right, new ideas were germinating. Inspired by the broad idea of rational choice, scholars were beginning to portray citizens as egoists unable to cooperate, voters as rationally ignorant, bureaucrats and politicians as maximizers of power and votes, and groups and social movements as rent-seeking enterprises. In such a perspective, which updated the old conservative distrust of democracy and of the state, citizens could not expect much from the democratic process or even from cooperative social relations. The best they could hope for was to have as many social functions fulfilled by the market as possible, this mechanism being immunized by competition from rent-seeking and power-seeking. In parallel, monetarism was rising, as an attack on the Keynesian ideas that counter-cyclical policies could be effective, that the state could manage the aggregate economy, and that unemployment and poverty could be challenged.

When conservatives took power, in the late 1970s and early 1980s, they had a counter-hegemonic set of ideas to implement. It was now the turn of the left to fight a rearguard struggle. So hegemonic became the right that even social-democratic governments and parties began to adjust. Some observers, on the left as well as on the right, started saying that the left-right debate had simply lost all relevance (Bobbio, 1996: 1-17). "In politics there is no left or right any more," proclaimed a 1996 *Globe and Mail* editorial, "just arithmetics" (November 25, 1996: A20).

Just as the "end of ideology" of the late 1950s and early 1960s proved to be a misleading impression, so is the "arithmetics" of the late 1990s. While neoliberalism prevailed, and while much of the political left was busy defending entitlements and established programs, new ideas were gradually emerging on the left. It is still hard to discern what these ideas are exactly, just as it would have been difficult in 1957 to see in *An Economic Theory of Democracy*, by Anthony Downs, anything but a limited intellectual exercise in pushing a logic to its limits (1957).

Some themes are nevertheless emerging. Chief among them is the idea of a basic income guaranteed by the state, whether as a pure, unconditional, basic income or in the form of negative income tax measures (Van Parijs, 1995; Offe, 1996: 201-221; Myles and Pierson, 1997). Central as well are: the affirmation of the need to respect difference and a multiplicity of identities; new conceptions of the economy as social; the idea of diverse personal paths towards economic and social integration; and the stress on democratic and empowering forms of street-level and local public administration (Noël, 1996). Many ideas and experiments are being developed around the common themes of enhancing real freedom and improving democratic procedures. While it is too early to speak of a coherent vision, all these ideas combine a commitment to equality with a rejection of welfare programs

defined solely as cheques and services provided to individual clients of the state. The idea is to use the state as a lever to empower persons and communities, vis-à-vis the market but also within the broader democratic process.

This is where decentralization fits in. In the neoliberal agenda, decentralization is sought to undermine national standards and programs, and to transfer as many activities as possible to the private sector. Conservatives decentralize to the market as well as to lower-level governments (Bennett, 1990: 1). The traditional left, committed to "national" standards, rightly sees this approach as threatening. New perspectives from the left, however, also emphasize decentralization, albeit in the name of local development, community associations, and empowerment. This new social-democratic understanding of decentralization could be associated with a "national" approach defined by a strong central government. Provincial governments, after all, are themselves big governments, nowhere near the ideal of the warm, autonomous community (Whitaker, 1992: 249). Still, a new sensitivity to the politics of place and of identity, a focus on the community and on empowerment, and an emphasis on local development make it easier for the left to question its old views about the superiority of more or less hidden, centralized, impersonal, and uniform programs. At the very least, the idea of decentralization is not anathema any more, and the alleged virtues of centralization can be questioned, theoretically, empirically, and politically. As a consequence, the federal principle, according to which different societies can arrange themselves differently, can also be reaffirmed.

In health care, for instance, decentralized alternatives to the 1984 Canada Health Act tend to be associated by the traditional left with three possible scenarios: a more or less equivalent status quo accepted by provincial governments committed to the same principles; an asymmetric version of the current situation, where at least some provinces would provide inferior services; and a market-driven scenario, where the current system would unravel and yield to private-sector alternatives (see Maioni's essay in this volume). The best scenario here is a fragile status quo. A new understanding is emerging on the left, however, that stresses the limitations of a federal policy defined solely by the provision of "medically necessary services." From this perspective, the defence of the Canada Health Act by the left also supports a traditional, and to a large extent outdated, understanding of health care as the medical treatment of sickness. Decentralization could allow a fourth scenario – the development at the provincial level of integrated and more encompassing approaches, better able to take into consideration the social determinants of health (poverty, for instance) and to devise innovative and preventive responses to what constitute public, rather than personal, health problems (Vaillancourt, 1997: 80–83; Courchene, 1994a: 173–89).

At any given time, "only a very limited number of changes have any significant chance of succeeding," wrote Michael Harrington in one of his last books. As a consequence, the left and the right always "explore a relatively narrow range of possible futures and, when they are serious, respond to the

same reality in fundamentally different ways" (1986: 15). In the 1990s, the two sides must respond to the economic and social challenges posed by globalization and by the failure of national markets to produce jobs and relatively well distributed incomes (Myles, 1996). The right is tempted to leave most functions to the market, but also finds appealing the possibility of a better policy mix, more favourable to competitiveness; the left is tempted by the assertion of national prerogatives, but also pays attention to what some have called "progressive competitiveness." Many, on both sides, explore the idea of a new social contract between the various social actors, one which would allow different societies to face the challenge of globalization without losing the capacity to maintain high levels of employment and an acceptable distribution of income (Rhodes, 1996).

In this country, the chances for such a social contract appear slim, given "the continuing and intensifying doubt about the very existence of a single Canadian political community" (Simeon, 1994: 42). This uncertainty, observes Richard Simeon, "is an enormous barrier to our ability to address the economic and social policy agenda," and it may be easier to seek social contracts at the provincial level (42-43; see also Courchene, 1995a). Decentralization, not centralization, may be needed to protect and improve Canadian social policies. The first step, however, would probably be to accept that there is, and there will be, not one but many Canadian welfare states.

CONCLUSION

In the summer of 1996, the American federal government imposed strict constraints on the states, forcing all of them to rethink their welfare policies in a much harsher fashion. "National" standards ended entitlements and imposed a punitive regime on the poor of every state. A year later, the new Labour government of Tony Blair held successful referendums to devolve powers to Scotland and Wales, and announced another one to give London its first elected mayor ever, in a clear reversal of years of strongly centralist conservatism (Apple, 1997). These two highly visible examples hold one basic lesson: centralization is not necessarily progressive, and neither is decentralization a monopoly of the right. Both sides in the political debate seek centralization and decentralization, depending on the context, to achieve different aims.

The progressive case against decentralization is much weaker, theoretically and empirically, than is usually thought. The evidence about "welfare magnets," "races to the bottom," and business-dominated lower-level governments is remarkably limited. The idea that these mechanisms nevertheless work because politicians believe they do is a much weaker, and also largely unsubstantiated, argument. Other arguments – about intergovernmentalism, accountability, unity, hidden transfers, efficiency, and morality – also appear unconvincing. Theoretically, these various arguments tend to empty social relations and politics of any content. A federal society

becomes an amorphous sum of individuals, holding no values or principles in common, uninterested in what happens in their own or in other provinces or states, and looking to the central government for an identity. Lower-level governments act as agents of capital or, at best, as promoters of their own power, and automatically adopt the policies business obviously needs.

A poor theory, with unconvincing evidence, the general argument criticized here is also poor politics for the left, because it relies too much on state power and too little on democracy. Indeed, beneath the view that decentralization is conservative lies the idea that elites at the centre know better what should be done, and the corollary notion that a common identity can be manufactured, and paid for, by the central government.

Consider, first, elitism. There are countless allusions, in the liberal or social-democratic defense of centralism, to the idea that open, public, and democratic deliberations are dangerous for the welfare state. Interest groups and lower-level governments are, of course, distrusted, but so is the public which, in general, is better kept at a distance from the nitty-gritty of redistribution. The more hidden the process and the policies, the better.

There is no doubt that policies involving rights and entitlements cannot fluctuate with daily opinion polls (Thompson, 1988: 155). Still, the popular support for the welfare state is very high and stable, even in the United States, and it probably constitutes the best guarantee against social policy retrenchments. "The success of retrenchment advocates," concludes Paul Pierson in a recent article, "will vary with the chances for lowering the visibility of reforms" (1996: 177). Retrenchment strategies also need to circumvent social movements and interest groups (Esping-Andersen, 1996: 24). An elitist and exclusive approach, deemed necessary by many advocates of centralization, is precisely what is needed to push aside public interest groups and pursue a politics of cutbacks "by stealth" (Jenson and Phillips, 1996).

The corollary idea of manufacturing a common identity with the help of central social programs is also poor politics. For one thing, as Will Kymlicka explains, "*to some extent* national identities must be taken as given" (1995: 184, emphasis in the original). A sense of unity and solidarity cannot be constructed solely from the centre. On the contrary, "people from different national groups will only share an allegiance to the larger polity if they see it as the context within which their national identity is nurtured, rather than subordinated" (189). Pushing ahead with central intervention can create a strong central government without giving rise to a strong national identity. This, argues Michael Sandel, is what happened in the United States:

As the welfare state developed, it drew less on an ethic of social solidarity and mutual obligation and more on an ethic of fair procedures and individual rights. But the liberalism of the procedural republic proved an inadequate substitute for the strong sense of citizenship the welfare state requires. (1996: 346)

In Canada, federal programs had this procedural, individualistic character: they "addressed Canadians as individuals more than as members of regional collectivities" (Jenson, 1995: 108). The Canadian welfare state nevertheless became better anchored than the American one, largely *because* Canada was a more decentralized federation than the United States (for one classical example, see Maioni, 1997: 424). Provincial welfare states emerged that gave a substantive content to social policy and, in the process, created strong provincial communities, able to emulate each other. If Canadians find their way towards a new social contract, this is where they will find it. Betting everything on elites and on central intervention is not only poor theory; it is also bad politics for the left.

How far should decentralization go? In a somewhat but not entirely different context – as he comments on "justice and tribalism" – Michael Walzer puts forward the seventeenth-century argument for toleration to propose a politics of accommodation, expressed in a variety of ways. The various outcomes, argues Walzer, "are more likely to be determined by concrete circumstances than by abstract principles." The most important task is to establish a consensus "that validates a variety of choices" or, in this case, to leave open various decentralization possibilities (1994: 80–81).

It may well be that in a decentralized, and perhaps asymmetric arrangement, some lower-level governments will adopt less progressive policies. This, however, is what the federal principle is all about: "to allow each government to look after its share of the common good *as it sees fit*" (Trudeau, 1968: 80, emphasis in the original). Presumably, differences in policies will correspond to differences in social preferences (as seems to be the case in both Canada and the United States: see Fletcher and Wallace, 1985: 151; Norrie, Simeon and Krasnick, 1986: 148; Erikson, Wright and McIver, 1993). If not, the political debate should operate, because democracy, as was noted by Pierre Elliott Trudeau, "has its logic, and freedom its requirements" (1968: 53).

Decentralization, many will argue, will not solve the Quebec problem (Whitaker, 1997: 58; Gibbins, 1997). This is true, not because more will always be demanded, but simply because the heart of the matter is recognition, not the division of powers. This is why at the outset I used a quote from Frank R. Scott to pose the problem as a general one, relevant for any federation. Decentralization will not solve the Quebec problem, but it may well solve the problem of the welfare state, by laying the foundations for new social contracts and well-anchored, improved social policies. In doing so, decentralization would also reaffirm the federal nature of Canadian society, certainly a positive step in the search for a new, viable partnership between Quebec and Canada. For this to happen, however, we must do away with the old notions of centralism, of manufactured identities, and of "people's packages" designed above the heads of Canadians. If the 1997 Speech from the Throne can be taken as indicative – with its multi-faceted proposal for direct interventions in social policy – this is not the direction the present fed-

eral government has chosen to follow (Prime Minister of Canada, 1997). In Canadian social policy, however, citizens, groups, and provinces are usually the most important players, and there is no reason for progressives to fear this reality.

Notes

- 1 Scott, 1977: 253. I am grateful to Bob Young, who invited me to write on decentralization, and to participants in the "Stretching the Federation" conference for helpful comments on an earlier version of this chapter. Keith Banting, Peter Graefe, Harvey Lazar, Ian Robinson, Richard Simeon, and participants at conferences in the Canadian Studies Program of the University of California, Berkeley and in the Political Science Department of Reed College also provided much appreciated suggestions, especially when they disagreed. I also wish to thank Alain Bernier for his work as a research assistant.
- 2 To characterize a federation, where the division of powers is defined by the constitution and, strictly speaking, does not imply a hierarchy, Daniel Elazar prefers using the term non-centralization (1987: 34). When he writes about the evolution of federalism, however, Elazar still refers to the more common concepts of centralization and decentralization (1987: 198-203).
- 3 Schram, Nitz and Krueger argue, using the combined AFDC-Food Stamps benefits, that there was in fact a "race to the bottom," which "compressed state benefit variation over time" (1998: 219-220). In many ways, the inclusion of Food Stamps provides a better picture. It gives, in particular, a more accurate representation of the income of families receiving social assistance. In-kind and uniform benefits for which all AFDC recipients in the country qualify, Food Stamps are financed almost entirely by the federal government and, unlike AFDC benefits, they are indexed automatically for inflation (Blank, 1997: 106; Rom, 1995: 72). For an argument about downward convergence, however, the addition of a federal and uniform benefit poses a problem. Since the 1970s, states have let inflation erode AFDC benefits and allowed federally financed and indexed Food Stamps to substitute for lost income. As a result, the federal, uniform component of the combined AFDC-Food Stamps benefits has become increasingly important and, not surprisingly, variations in the combined benefits have decreased (Moffitt, 1990; Blank, 1997: 100-107). This convergence did not stem from a "race to the bottom," but rather from an increase in the federal role, for variations in AFDC benefits alone did not diminish (Schram, Nitz and Krueger, 1998: 218). As for the decline in AFDC and in the combined benefits, many factors other than competition are at play. At the very least, one should note that federal social assistance programs were cut as well (Blank, 1997: 93). In a recent pooled time-series analysis, Jack Tweedie

- finds that while high-benefit states seem influenced negatively by benefit levels in surrounding states, "low-benefit states respond to other states' benefits by *increasing* their own benefit levels" (Tweedie, 1994: 667, emphasis in the original). This dual pattern evokes mutual adjustment and policy diffusion more than pure competition.
- 4 William Robson updates this argument when he notes that, "in policy areas such as labor standards, Canada's diverse jurisdictions have been cited as inducing a race to the top" (1992: 95).
 - 5 Diffusion, of course, is not always a progressive trend. See, for instance, Brooke, 1997.
 - 6 Obviously, the "rights" of Southern states also oppressed African Americans. Note, however, that, until 1964, the federal government was itself "a pillar of segregated race relations," using its power to promote segregation inside the federal government and in the entire American society (King, 1995b: 5-9, 207-209). Many have argued this legacy still has not been overcome in federal politics (Quadagno, 1994; Williams, 1998).
 - 7 David Cameron comes close to this perspective when he deplores the fact that "serious discussion of the trimming and reform of substantive social services gets dispersed to the provinces and provincial communities where the direct encounter between citizen and public service occurs" (1994: 440). Roger Gibbins more openly argues that "governments that are close to the people are sometimes (but not always) less attentive to human rights and more attentive to localized economic interests than are governments that remain more remote from the people" (1997: 19). It is unclear how a central government that is also elected is "more remote from the people."
 - 8 Many scholars have portrayed the new program, Temporary Assistance for Needy Families (TANF), as decentralizing because it creates a block grant that leaves much flexibility to the states (Cope, 1997; Lurie, 1997). The thrust of the reform, however, including the new work requirements and time limits, was and will remain defined in Washington, D.C. What has changed is the nature of federal regulations, which "have morphed from the protective to the punitive ... Rather than mandating an inclusive eligibility, the new law mandates exclusions and limits" (Gilbert and Terrell, 1998: 235; Schram and Weissert, 1997: 2-5).

COMMENTS ON ALAIN NOËL'S PAPER STEPHEN BROOKS

Is decentralization conservative? The question will strike many as belonging in the category of self-evident truths disguised as queries, like "Is the pope Catholic?" Indeed, few claims about federalism have been as widely accepted in recent years as the argument that decentralization is conserva-

tive in terms of either the motives of those who support it, or its distributional consequences, or both. As Alain Noël observes, the evidence adduced in support of this proposition takes several forms and comes from corners of the intellectual map as different as philosophy and economics. To challenge the orthodox view of decentralization's ideological associations would seem a mission with little hope of success.

This is, however, precisely the challenge that Alain Noël sets himself in his careful and convincing analysis of the arguments and evidence on decentralization and the welfare state. Noël identifies six categories of arguments in the debate on this relationship. He finds that none of them is without certain weaknesses and concludes that "the effects of decentralization on the overall orientation of public policy and on interregional conflicts and accommodations remain basically uncertain." Indeed, Noël goes further to suggest that decentralization "may well solve ... the problem of the welfare state, by laying the foundations for new social contracts and well-anchored, improved welfare states."

I agree. In fact I find Noël's analysis of the weaknesses in the decentralization-equals-erosion-of-the-welfare-state thesis quite compelling. So rather than blowing whatever minor reservations I may have into trumped-up criticisms, or superfluously restating arguments that he has so ably made, I would prefer to respond to his chapter by posing – and answering, I hope – a question that flows logically from Noël's rebuttal to the orthodox view on decentralization. That question is: Why is decentralization generally portrayed as part of a neoliberal ideological agenda whose consequences are harmful for the poor, the marginal, and just about any group that benefits from the welfare state?

This is a question that concerns the sociology of ideas and the influences on intellectual production. I hope to show that the misleading portrayal of decentralization as inherently conservative is in large measure due to factors that tell us more about many of the intellectuals who write on federalism and the welfare state than about the subject *per se*.

GUILT BY ASSOCIATION

Ideas are sometimes judged by the company they keep, and the company kept by decentralization is, in the eyes of many critics, sufficient indictment of this idea. In the United States, the New Federalism was launched under Richard Nixon and resuscitated under Ronald Reagan. Under Nixon the term referred to General Revenue Sharing (GRS), whereby Washington would share tax revenues with state and local governments with few strings attached. This was a reaction to the proliferation of categorical grants made by Congress – grants that imposed conditions on recipients as to how the money should be spent and how programs should be delivered. In fact, however, categorical grants continued to grow, and GRS proved to be essentially an additional source of revenue for the states. Thus it was that the "new" New Federalism of the Reagan years involved an end to GRS, but also a

slowdown in the rate of growth in federal aid dollars to state and local governments. By the 1980s most federal aid money went towards supporting health, education, and income security programmes, so that the Reagan administration's efforts to cut back on federal transfers – which never succeeded, for they were only slowed down – was portrayed as an assault on the welfare state.

Nixon and Reagan are, of course, identified with conservatism, and Reagan in particular is associated with an anti-state, pro-market philosophy of governance. Their advocacy of the New Federalism is generally, and fairly enough, at least in the case of Reagan, interpreted as having been motivated by a desire to rein in welfare state spending. Those who would make a case for disentangling the financial web of federalism, and reducing the national government's role in financing regional and local programs and enforcing national standards, are almost automatically suspected of having neo-con sympathies. It is a classic example of guilt by association. To support policies that *appear* to resemble those championed by a president whose very name has become synonymous with avarice and inequality in the eyes of liberal intellectuals is enough to discredit one and one's ideas.

Who champions decentralization in Canada? Most of its prominent advocates are, admittedly, on the right of the political spectrum. They include Alberta premier Ralph Klein and his Conservative government, Preston Manning and the Reform Party, Michael Walker and the Fraser Institute, and conservative journalists Ted Byfield and David Frum, to mention a handful. If *they* support decentralization, surely that proves that it is inherently conservative!

Well, not necessarily. This sort of *ad hominem* criticism, whereby arguments are dismissed because they are viewed as extensions of the politics of individuals or groups that one finds repugnant, is common. But it is risky to judge ideas by the company they keep. George Woodcock was a staunch advocate of decentralization, but I would be surprised if anyone considers him to be on that account a soul-mate of Ted Byfield. And Pierre Trudeau (who, granted, as prime minister did much to advance the cause of national standards and little to challenge Ottawa's use of the spending power) was once a vigorous critic of centralized power. No one mistook his arguments, however, for the anti-Ottawa position of Maurice Duplessis.

SISTER CONCEPTS

Decentralization is routinely associated with several other concepts that, according to some critics, are inherently opposed to the welfare state. Among these are the concepts of efficiency, subsidiarity, accountability, globalization, and managerialism. Together they are argued to constitute an anti-state discourse that would see governments stripped of their capacities to redistribute wealth and protect the marginal.

It certainly is true that decentralization is often defended on the grounds that it may provide more efficient delivery of public services, thereby reduc-

ing the burden on taxpayers at the same time as local autonomy is respected. Moreover, the concept of subsidiarity is generally interpreted to mean that decision-making authority should belong to the level of government closest to the community, unless moving it to a higher level would lead to gains in efficiency. Lenihan, Robertson and Tassé (1994) argue that this should be the criterion used to resolve disputes over what responsibilities are appropriately federal ones and which are better left to the provinces. The Group of 22 (1996: 11) makes the same point in arguing that "subsidiarity should be a key operational principle in rebalancing the federation, especially when it comes to reconfiguring the division of powers and reducing overlap and duplication." It does indeed appear that the concept of subsidiarity, as employed in discussions of Canadian federalism, is often assimilated to that of efficiency and enlisted in the cause of decentralization.

But leaving aside the legitimate question of whether this understanding of subsidiarity is faithful to the original meaning of the principle as laid down in the Maastricht Treaty, basing decisions about the federal division of responsibilities on respect for local autonomy and efficiency does not necessarily stack the deck against the welfare state. As Noël reminds us, "the idea that lower-level governments have little interest in social policy" is supported neither by the historical record nor by any convincing logic. If it is determined, therefore, that decentralization is likely to deliver efficiency gains, there is no reason to expect that the price of these gains will be a loss in the will or capacity of governments to pursue non-economic values – such as those relating to social justice – through their policies.

I am not trying to suggest that decentralization is never part of an anti-state discourse that relies on concepts like efficiency and subsidiarity to attack the redistributive functions of central governments. My point is simply that those who make this argument sometimes establish false dichotomies, as between efficiency and social justice, or between accountability/transparency and the ability of the state to "hide" redistributive transfers from taxpayers who, it is argued, would not support this spending if they were aware of it.

FEAR

There is a realization by many that decentralization threatens the institutions, groups, and programs on which their status, prestige, influence, or cherished beliefs depend. I do not mean to suggest that crass self-interest motivates opponents of decentralization. I do mean to suggest, however, that their opposition is reactionary in the sense of being inspired by an inability or unwillingness to abandon – or even to see seriously reformed – a status quo with which they feel comfortable and which constitutes their vision of Canada.

The phenomenon that I am alluding to is, I think, widely understood. Since the rise of neo-liberalism the left has more often than not been placed in the historically unfamiliar role of defender of the status quo, attempting

to conserve the policies and programs associated with the welfare state. Only recently – say, during the last ten years – has the left done any serious thinking about alternatives to the top-down, big government, welfare-state model that became the norm in western democracies after the Second World War. Decentralization challenges that model, although not necessarily the values it embodies, and the left's response to this challenge has to a large degree involved denial and rejection.

IGNORANCE

The claim that decentralization is inspired by neoliberalism and leads to results that harm the weak seems to me to be based on an ignorance of the circumstances of countries other than our own. Noël makes this point when he refers to the recent decentralizing measures of the Labour government in the United Kingdom. The frequently heard, and perhaps even more frequently believed, statement that "Canada is the world's most decentralized federation" seems to me to be indicative of the ignorance of which I speak. More decentralized than Switzerland? Than Belgium? The truth of the claim is not self-evident, despite the fact that it has over the years been uttered by the likes of Pierre Trudeau and Stéphane Dion.

But the real question is not whether Canada is already more decentralized than all, most, or some other federal political systems. It is whether more, as opposed to less, decentralized structures for the provision of particular public goods – health, education, and social housing, for example – are necessarily linked to conservative ideology. Posed this way, I think that the answer to the question is obviously no.

Historically, France has had one of the most centralized of educational systems and also one of the most elitist. The Belgian system is much more decentralized and also more egalitarian. Belgium is also a case where state reforms have produced greater decentralization without this being linked to a neoliberal agenda. Indeed, the "Europe of the regions" movement in the European Union seems to show that decentralist philosophies of governance and concepts like subsidiarity are not necessarily linked to neoliberalism or attacks on egalitarianism.

Sceptics may insist that centralism is still better because it provides for a deeper and more secure funding base for social programs, but to some extent this claim is inevitably paired with the dubious premise that more money is necessarily better. This certainly is questionable in such fields as education and health care. Canada, Germany, and the United States all spend two to three times the money, per student, on education that Hungary spends, and yet Hungarian students do considerably better on standardized math and science tests. The United States and Canada top the international table in per capita health care spending, despite having relatively young populations compared to other advanced industrial democracies, without this translating into healthier citizens than in lower-spending Belgium, the Netherlands, France, or Japan.

Noël shows that the empirical record does not support the generalization according to which more decentralization = less redistribution. So why do the Canadian critics of decentralism cling to this claim?

THE FRAGILITY OF NATIONAL UNITY

Never far from the surface of debates on decentralization in Canada is the idea that national standards and federal dollars provide a major part of the glue that holds this country together. Medicare, including the values enshrined in the Canada Health Act, is the example most often cited. But there is a subtext as well, and it is that anything which threatens these national standards and Ottawa's role in financing and shaping social policies will make us more like the United States – necessarily a bad thing in the eyes of Canadian left-nationalists. And so centralism is defended on the dual grounds that it is necessary to maintain the fabric of national unity and to protect our distinctive culture.

This view is elitist and is presumptuous in its claim that national unity depends on social and cultural policies made in and administered from Ottawa. Noël quite rightly takes this view to task and reminds us, quoting Trudeau, that the federal principle is about “allow[ing] each government to look after its share of the common good *as it sees fit*.” And in words that could be taken straight from a Preston Manning speech, Noël declares that “beneath the view that decentralization is conservative lies the idea that elites at the centre know better what should be done, and the corollary notion that a common identity can be manufactured, and paid for, by the central government.”

Noël's argument about the elitism of decentralization's critics does not, however, make him a soulmate of Preston Manning and a booster of populist politics. And although he insists that his chapter is not about Quebec, I think that in order to understand the nature of his argument about elitism one must situate it within a Quebec context. Successive Quebec governments have, of course, created a network of social policies distinctive from those in the rest of Canada, and most Québécois intellectuals have rejected the notion of national standards and other aspects of centralized social and cultural policy. At the same time, most observers would agree that Quebec's social policies are among the most “progressive” in the country, as this word is conventionally understood. In other words, the fact that Quebec has to a large degree charted its own course has not weakened that province's welfare state. The belief among English-speaking liberal intellectuals that, when it comes to the welfare state, if Ottawa does not do it, it won't get done – or at least not adequately – ignores the lessons of Quebec's experience. Moreover, it is a belief that certainly is not shared by Québécois intellectuals, whether separatist or federalist.

Inevitably, this brings us to the question of why English Canadian intellectuals so often make the argument that a strong central government role in the financing of the welfare state and the enforcement of national standards

is needed not only to maintain any semblance of a compassionate social policy, but also to preserve the unity of the country. Challenged to identify the core values that characterize Canadian society, defenders of centralism will automatically mention Medicare and, more generally, redistributive-egalitarian social policy. Anything that weakens federal authority, they argue, necessarily weakens the protection of these values and ends by weakening the bonds of national unity that have been forged through what Richard Simeon (1994) describes as the Social Contract of post-World War II Canada.

This begs the question. Is the unity of English Canada really such a fragile plant? Has it been constructed on a foundation of Ottawa's spending power and national standards in the area of social policy, along with what Philip Resnick (1984: 38) calls the "organization of our civic consciousness" in the realm of culture? And will our social capital run down, and the survival of distinctively Canadian values be imperilled, by a diminished federal role in social policy? Along with Noël, I doubt it.

Rapporteur's Summary

DAVID CAMERON

I must say that a rapporteur's job is not a happy one. This is for several reasons:

- The job starts at the end of the conference. In fact, when the rapporteur's job begins, the conference is effectively over. Some people have already skipped out a bit early. Those who remain have their minds on departure; they're checking their plane tickets, calling taxis, gathering their luggage, watching the clock.
- As rapporteur, you have to pay attention to what is being said all through the proceedings. You can never slack off. Yet, are rapporteurs not human? If you prick us, do we not bleed? Do we not have moments of down time like everyone else? No, we do not. Not as rapporteurs. We're not allowed to.
- You have to talk about what everyone else has already heard. Everyone in the audience has been at the conference, after all. Everybody figures they've been there, done that, seen the movie. Now they just want to go home. But they have to sit still while someone else tells them what they already know, namely, what happened at the conference.

Well, too bad. That's my job and I'm going to do it.

For a small conference that lasted only a day and a half, *Stretching the Federation: The Art of the State* stimulated productive and lively debate, and covered a surprising amount of ground. The papers clearly challenged the participants, as was evident, first, in the character and quality of the commentaries, and second, in the free-wheeling discussion that followed.

The conference can be understood as occurring at four different levels of generality.

LEVEL I. A DISCUSSION OF PARADIGMATIC EXHAUSTION

The first and most general level involved a discussion of the exhaustion of what might be called a charter paradigm. Paradigms are one of the favourite playthings of social scientists, so it is hardly surprising that I find myself talking about them in my remarks. But in fact I think this is justified by the nature of the conference itself.

It might be argued that, as a civilization, we in the West – and indeed, people in much of the world – are living through an era in which the old paradigm of the nation-state is showing distinct signs of age. The political forms and structures which gave meaning and order to the old way of doing things cannot be counted on to do their job any longer.

People everywhere, in many countries, in one way or another, are noting the exhaustion of the paradigm of the nation-state, but no new, compelling model or set of organizing principles or paradigm has as yet emerged to replace it. We are not quite in the condition of the survivors in *A Canticle for Liebowitz*, who – centuries hence – are portrayed as picking through the rubble of our now extinct, once-modern civilization, trying to figure out what it was all about and how it operated, but it is now possible to imagine looking back, from another vantage point, at our civilization and the nation-state system which so powerfully defined it. It is strange to realize that the institutions which compose our daily life will one day be examined as historical artifacts.

Given that the new paradigm or set of organizing principles is not yet clear, this conference can be understood as one in a series of probes – sticks poking gingerly at the new, strange paradigmatic beast, slouching to Bethlehem to be born.

Existential questions arising out of this reality hovered in the background of much of our discussion at this conference and occasionally elbowed their way directly into our line of vision, most notably when Michael Keating in his wide-ranging opening remarks noted how new definitions of territory are displacing the traditional understanding of the nation-state. This was a theme Ronald Watts picked up on in his commentary, referring to David Elkin's recent exploration of non-territorial forms of sovereignty in *Beyond Sovereignty* (1995).

LEVEL II. A DISCUSSION OF PLURALISTIC SOCIETIES AND MULTIPLE GOVERNMENTS

At this level, conference participants explored the modern phenomenon of people feeling a sense of identity and affiliation with more than one community at the same time, as well as the increasingly common contemporary reality of multiple governments ruling over the same people and territory.

Normatively, the issue seemed to be: How do questions of space and questions of scale relate to the provision of good government and the maintenance of healthy communities?

Analytically, the issue was framed in something like the following terms: What impact do altering conceptions of space and scale have on government structures and on societies?

There appeared to be a shared recognition that powerful forces of change – beyond the control of any single agent – were altering the conditions of existence in most Western countries, and that this reality was escaping the analytical categories we have conventionally used to understand and explain it. Definitions of different forms of political organization, for example, seem to be becoming blurred and seem to bleed into one another. You have, by way of illustration: federations, whether classical, layer cake, marble cake, or upside-down cake; federalizing political regimes, which is to say, political systems which appear to be evolving in the direction of a full-scale federal system; highly regionalized, unitary states; emerging region-states; and the European Union (EU), a newly emergent form of government for which there is no name.

Michael Keating spoke to us at this conference on federalism, not as a student of federalism, but as a self-declared regionalist and a self-proclaimed Europeanist; yet it was in no sense difficult for us *federalists* to understand him and to appreciate the points he was making. In fact, the commentary of Ronald Watts expanded in its own way upon many of the points Michael Keating was making.

Alain Noël's thoughtful examination of the policy and ideological implications of decentralization can be understood at this level, as can Stephen Brooks's comments about the reasons why people believe what they believe about the impact of decentralization.

LEVEL III. A DISCUSSION OF FEDERALISM AND, MORE SPECIFICALLY, CANADIAN FEDERALISM

Consider first of all the formal theme of this colloquium: *Stretching the Federation: The Art of the State*. At this level, we were addressing the following questions: How are federations evolving? How, more particularly, is the Canadian federal system evolving? What are the problems and opportunities confronting Canadians and their federal order at this time?

Given the focus in our discussion on equity in the allocation of benefits and burdens, I was reminded at times of Raymond Breton's wonderful definition of a country: "A country is a territory over which its citizens are prepared to redistribute."

Much of what Ron Watts had to say, aspects of Alain Noël's paper and Stephen Brooks's comments on the Noël paper, Evert Lindquist's review of

overlap and duplication together with Peter Meekison's review of the review, the discussion on the economic union involving Tom Courchene, Bill Robson and France St-Hilaire – all of these fitted nicely into this third level of discussion.

This brings me to the fourth and final level at which the conference discussion was carried on.

LEVEL IV. A DISCUSSION OF A SPECIFIC REFORM PROPOSAL FOR THE CANADIAN FEDERATION – NAMELY, ACCESS, IN EITHER THE INTERIM OR FULL MODEL

One component of the conference agenda was to extend the analysis of Tom Courchene's ideas for restructuring the Canadian federal system. Here we have Antonia Maioni's paper assessing ACCESS as it relates to health policy in Canada, and John Richards's comments on the Canada Health and Social Transfer and on the Canada Health Act. We also have the paper by Paul Boothe and Dereck Hermanutz looking at both the federal and province-by-province fiscal impacts of the ACCESS models.

Having set out these four levels or categories as a way of understanding what we did at the conference, I have to say that the papers and the discussion really respected no boundaries. Participants were perfectly willing to play off one another's ideas. That is why there was, I think, a thematic coherence to the two days and why the conversation was as vivacious and as interesting as it was. People moved happily back and forth between the grandest levels of abstraction, such as the alleged decline of territory as a factor in modern government, to the most mundane and terre-à-terre considerations, such as the CCRA (and I confess I still don't know what the letters stand for), the tax on tax and the tax on base, PIT, CIT, EPF, CHST, CHA, and all the other little acronymal gremlins that inhabit the Canadian federation.

Perhaps the most striking feature of these two days lay not so much in what was discussed, but in the tone or manner of its discussion. There seemed to be a common willingness to question established assumptions. This openness of mind was well summed up by Alain Noël's surprised confession that the paper on decentralization that he actually wrote was not at all the paper he expected to be writing when he began. Conference participants, recognizing the degree to which the world around them was altering, seemed prepared to reconsider existing arrangements and traditional beliefs and to think beyond the conventional categories. The colloquium seemed to me to be not just about stretching the federation but about stretching our minds as well.

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