

CONFlict OF TASTE & CONFlict OF CLAIM  
IN FEDERAL COUNTRIES

BY

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and

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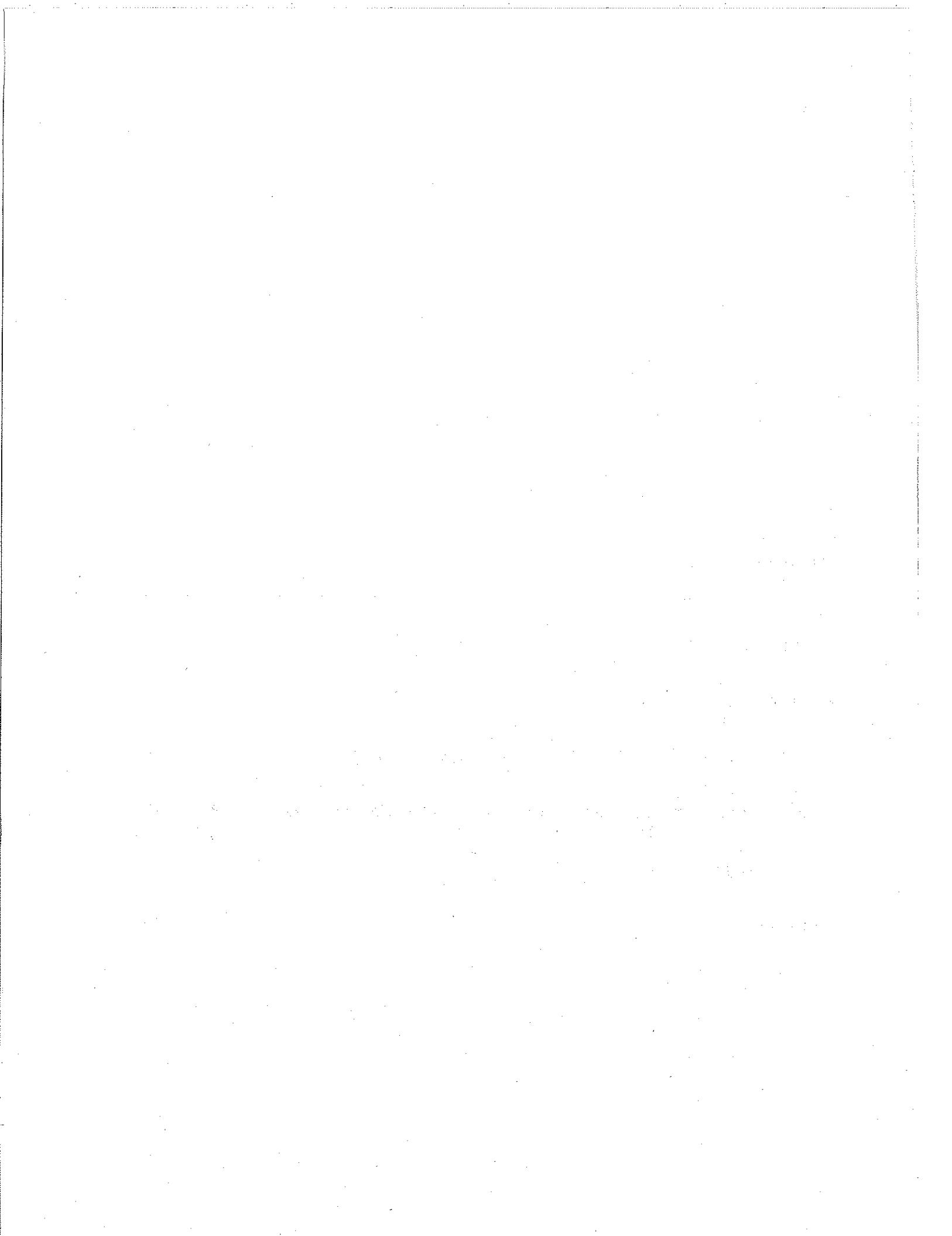
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## PREFACE

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The key to understanding the politics of any nations lies in the relationship between its political institutions and the underlying pattern of conflict in the wider society. In this paper Jack Mintz and Richard Simeon explore the implications for federal governments of two forms of conflict between regions: conflicts of taste which are rooted in cultural diversity, and conflicts of claim which flow from competition over the distribution of economic resources. They argue strongly that the two kinds of conflict pose very different challenges to the capacity of federal institutions to accommodate regional tensions. Their paper makes an important contribution to both the theory of federalism and our understanding of recent Canadian experience.

Institute Discussion papers are designed to provide an opportunity for discussion of important issues in federalism and intergovernmental relations. The views expressed are those of the authors.

Both authors of this paper are faculty members at Queen's University. Jack Mintz is Assistant Professor in the Department of Economics, and Richard Simeon is Professor of Political Studies and Director of the Institute of Intergovernmental Relations.

Keith G. Banting  
Associate Director  
June 1982

## 1 INTRODUCTION

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In this paper we examine the character of interregional conflict which may arise in federal countries. We introduce a distinction between two forms of conflict which are logically independent of one another though often empirically entwined. They have very different implications for the reconciliation of differences and for the institutional and political mechanisms through which they are to be managed. We label these two kinds of conflict conflict of taste with regard to values and conflict of claim with regard to the distribution of resources.<sup>1</sup> Our analysis grows largely out of an attempt to understand the Canadian case but we believe the concepts and approach developed here may also illuminate divisions in other federal countries.

Much of the theory of federalism is designed to understand the problems posed by conflicts of taste. Theorizing has tended to neglect those of claim. But in fact conflicts within the Canadian federal system – and perhaps in others – appear in practice to be based not just on differences in taste among regions but on the distribution of economic wealth amongst regions, conflict of claim. Understanding these differences, therefore, is essential to understanding contemporary conflicts in Canada.

In the remainder of this introduction we advance the central distinction between the two kinds of conflict and introduce some other major concepts

and assumptions which will guide our analysis. In Part II we set forth formal models to explore the implications of each form of conflict more fully. We then explore in Part III the possible institutional mechanisms and rules which govern the accommodation of conflicts of taste and claim and draw out some political implications of our analysis.

Both types of conflict we study are predicated on a regional or territorial distribution of preferences or interests. In a federal system, of course, interests are based on a number of lines of cleavage and the extent to which they are territorially concentrated is an empirical question which in turn has important implications for such questions as the division of powers.

But, given regionally-based identities and preferences, differences of taste refer to the preference of regional populations for distinct and variable "baskets" or "packages" of public and private goods or services. If regional populations have distinct cultural characteristics, or a distinct socio-economic base, then their preferences for public policy are likely to vary as well. They may, for example, choose to weight economic development more heavily than welfare, to stress different cultural values in an education system, to be more or less egalitarian in social policies. The sharper such differences among regions are the greater the potential costs if decisions about production of public goods are centralized. If the wishes of a country-wide majority are imposed, then a number of regional majorities are likely to be frustrated, especially if the regional units vary greatly in size. Conflict of taste, then, refers to the extent to which regional populations, for whatever reasons, share different or incompatible preferences about the content of public policy arising from differences in social or cultural values. Put another way, conflict of taste increases to the extent that regional majority preferences diverge either from the majorities in other regions, or from the national majority.

The basic principle for the design of federal systems which arises from this perspective is to distribute governmental responsibilities in such a way as to maximize the welfare of citizens in each region, allowing them to receive the packages of public and private services they wish and minimizing the extent to which they are frustrated by the imposition of others' values, or by external veto. Such a strategy might be called "disengagement"; authority is allocated to regional units of government in those policy areas where differences in regional preferences are likely to be large. The central government's role could be restricted to co-ordinating the actions of regions where spillovers occur, without defining national values. Regions could still differ in their ultimate choice of public policy.

This is part of the logic behind the adoption of federalism in the first place. If all divisions are national and if regions do not possess distinct preferences, then a unitary system may be most appropriate. If conversely, interests are shaped by the region, then there is little basis for unity. In Canada it was largely the realization of the distinct interests of Quebecers, especially in such fields as education and social services, which led to adoption of a federal system, assuring that Quebecers would not be subject to the will of the Canada-wide majority in those areas where they had distinct preferences.

This was also the justification for federalism offered by the Rowell-Sirois Commission. While recommending centralization with respect to major redistributive policies, the commission argued that regional diversity demanded decentralization in areas closely related to cultural and social values. As D.V. Smiley observes, "full provincial responsibility in the fields of health, welfare and education, with the exception of a relatively few federal responsibilities, was seen by the commission to be essential to the maintenance of those provincial particularisms which were strategic to the establishment of the Canadian

federal system and whose continuing existence made necessary the preservation of that system.<sup>2</sup>

Later, Quebec's Tremblay Commission rooted its claim for provincial autonomy in the uniqueness of the provinces' values. More recently still, the Pepin-Robarts Task Force on Canadian Unity strongly emphasized the complex nature of Canadian diversity and justified federalism as the system "best suited to our diversity."<sup>3</sup> "Duality and regionalism," it says, "lie at the heart of the Confederation Crisis" they were used as yardsticks "in analyzing the present situation and proposals for change."<sup>4</sup> The report did, however, also address issues of the "sharing" which is more closely related to conflicts of claim.

Thus conflict of taste arises out of provincial differences in policy preferences and out of the decision rules by which preferences are enacted. Conflict occurs when a regional majority feels either that it is not free to enact its preferred policies or that policies it opposes are forced on it. Studies of Canadian regionalism which emphasize the unique historical experience of regions or their distinct demographic and cultural character imply that these kinds of differences give rise to divergent policy goals. The implication of course is that if such underlying differences were to decline then so too would varying preferences and with them the basis for regional conflict.

Conflict of claim, however, does not depend for its intensity on such cultural differences. It arises where regional populations share values but disagree on the distribution of wealth among them.

Conflict of claim thus refers not to distinct preferences but rather to the regional distribution of wealth. It is based not on differences among but on relations between the regions, and is rooted in competition among them. Conflict of claim implies that in order for a region to get what it

wants, it must gain something from other regions. The conflict between an Albertan who wants high energy prices and low tariffs and an Ontario who wants cheap energy and high tariffs is one of claim.

Conflict of claim thus does not require that there be distinct culturally-based differences in preferences among regions. Indeed it is most intense when regional populations want the same things. Conflict of this sort requires only that the region or province is considered by its citizens to be a relevant criterion by which to judge the distribution of benefits. It requires some degree of regional or territorial identity and a consequent tendency to assess distributional issues in terms of regionally defined collectivities, rather than non-regional ones such as occupation or religion. It can take the form of direct competition among regions, through competitive bidding for investment, imposition of barriers to trade and beggar thy neighbour policies or debates over distribution of resource wealth. Or it can take the form of conflict over the role of the central government and the extent to which its policies are felt to benefit some regions over others, whether in taxing and spending policies or in its more structural policies, such as tariffs, transportation or pricing of natural resources.<sup>5</sup>

It is possible to conceive of an "efficient" solution to the problem of conflict of taste, but no such "efficient" solution is possible with conflict of claim since the issue is one of distribution. The perspective is not that of the aggregate welfare of the whole country but of the desire of each region to maximize its welfare and to gain the greatest possible share of the benefits of association.

The central political question for conflicts of claim, therefore, is how to structure decision-making processes so as to adjudicate between competing regional claims in such a way that each region feels that it receives some kind of "fair share". Since conflicts of claim involve

competition for scarce resources, the relative bargaining power of regions and the implications of institutional arrangements for such power are central to these conflicts. Conflict of taste can, with some important exceptions, be dealt with through disengagement, leaving each unit free to do as it wishes. By definition, conflict of claim cannot be solved by disengagement. The ways in which institutions structure these relationships are therefore crucial.

In the following section we discuss these issues in more detail. Several other assumptions in our analysis should be noted before proceeding. First, for the most part we treat regions as givens, as *a priori* units of analysis. In the Canadian context we consider regions and provinces to be synonymous. Second, we assume the existence of the federal system to be in some sense based on consent rather than coercion. This implies that in principle, regions have the alternative of opting-out or secession, if over the long term the perceived costs of continued association outweigh the benefits.

Both conflicts of taste and claim have existed throughout Canadian history. Some evidence suggests, however, that conflict of taste may be decreasing and that conflict of claim today poses the most difficult problems. Thus, survey evidence on the preferences of citizens suggests that in most areas of public policy the primary divisions among the electorate are only weakly related to province or region and that these relationships are becoming weaker. The evidence does not suggest that citizens in different regions wish quite different mixes of public policy.<sup>6</sup> Similarly, in a study of the western provinces, Roger Gibbins finds that demographically, economically, culturally and socially, western provinces are becoming more and more heterogeneous internally and less and less distinct from the rest of the country. He subtitles his book, "Regionalism in Decline."<sup>7</sup> There is thus some evidence of convergence in tastes across regions, and increasing diversity within them. But this

convergence has not been accompanied by declining levels of conflict; nor has it meant an erosion of the power of provincial governments. Rather, we see increasing regional conflict and the emergence of sharper manifestation of regional identities and regional loyalties. This apparent paradox can be understood in terms of conflict of claim.

## 2 THE NATURE OF CONFLICT IN FEDERAL SOCIETIES

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This section develops in detail the theoretical notions of conflict of taste and conflict of claim defined in the Introduction. Before elaborating upon these concepts, it is important to discuss the perspective upon which our analysis is based.

The option of a region's withdrawal from the federation, noted earlier, places a constraint on the central government's actions. This constraint has several implications. First, normative criteria such as "equity" and "efficiency"<sup>8</sup> used by economists in evaluating policies can be applied at both the regional or the national level. At the national level, efficiency requires that the maximum level of economic well-being of a representative "national" consumer be achieved. Equity in a "national" sense requires an optimal distribution of wealth amongst individuals throughout the nation. However, a regional community is assumed to be concerned about its own efficiency and equity, not the welfare of the nation, unless the region expressly chooses to be concerned about national welfare. The region, therefore, is seen as being in the same relation to the country as a whole as a country to the community of nations.

The central government will also be more constrained in implementing allocative and distributional policies. For example, suppose the central government achieves an economic allocation satisfactory to all regions. If

the central government wishes to redistribute resources to satisfy standards of national equity then a particular regional community may be opposed to redistributive policies that lower the welfare of the region, either by reducing resources available to it or undoing regional distributive policies. Regional and national notions of "equity" can then be in conflict. Moreover the option left to the region of withdrawing from the federation severely limits the ability of central government to carry out allocative or distributive policies to satisfy notions of national efficiency and equity.<sup>9</sup>

#### Conflict of Taste

We introduce a simple model to illustrate the notion of conflict of taste in a federal society. Suppose there are two regions (A and B) both of which consume a private good (X) and public good (Y). In Diagram 1, tastes of the regional communities differ as represented by the respective indifference maps of each regional community ( $U^A$  and  $U^B$ ).<sup>10</sup> Given the same level of income, region B prefers more of the public good compared to region A.

The production of the regional public good can involve an interjurisdictional spillover. The public good produced by one region benefits the production of the public good consumed by the other region. There are several examples of such public goods in the fields of health, education, transportation and defence.<sup>11</sup>

For simplicity, there is no trade of commodities between the regions. The two regions, moreover, have identical factor endowments and production possibility frontiers that incorporate the externality. If the regional economies were allowed trade with each other by introducing more commodities, the analysis would be little affected but the presentation would be complicated.

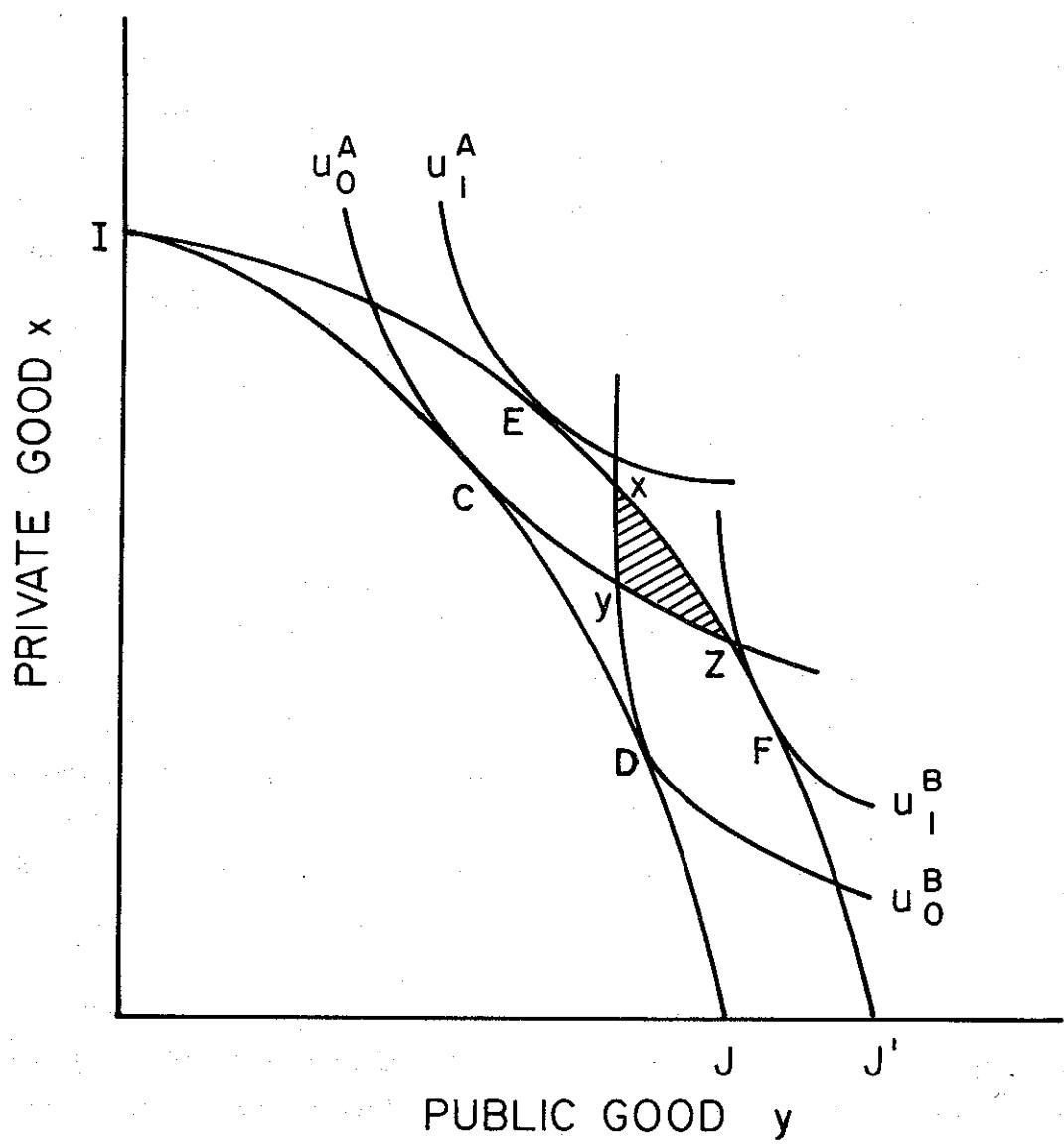
To begin, consider the position of the two regions in autarky in that they do not take into account the benefit or cost of their public good production on the production capabilities of the other region's public good. Each region maximizes its welfare ( $U^A$  and  $U^B$ ) subject to the transformation constraint  $IJ$  which is identical for the two regions. As shown in the diagram, Region A chooses to produce less of the public good at Point C than Region B at Point D as required under our earlier assumption of different tastes.

Now suppose the regions form a union and co-ordinate public good production to take into account the interjurisdictional spillover. Each region under autarky produced too little of the public good<sup>12</sup> as it ignored the benefit that the other region receives. If the two regions co-ordinated their production plans of the public good, efficiency gains are possible for each region as the production possibility frontier shifts in both regions from  $IJ$  to  $IJ'$ .<sup>13</sup> In the diagram, both regions would find that the relative price of public goods initially falls as the cost of the public good to a region is reduced by the amount of the benefit received by the other region.

If each region took into account the interjurisdiction spillover when making decisions on the allocation of resources between public and private sector production, then Region A and B could achieve the "first best" positions E and F respectively where the welfare of each region is maximized. With different tastes among the regions for public and private sectors goods, the "first best" solution requires regional differentiation in the amount of the public good consumed. In the diagram, Region A desires to consume less of the public good compared to Region B.

There are several circumstances under which regionally differentiated consumption of the public good may not be possible. If the regional communities allowed the central government to provide the public good,

DIAGRAM I



then the central government may invoke national standards in the interest of making the good available on the same terms to all individuals. This argument raises the normative issue of whether regional community preferences should be recognized at all. Regional differentiation in the provision of a public good may also be difficult to implement in practice because it is hard to measure all the spillovers that occur.

In the next section, we will discuss various solutions for resolving the conflict of tastes but at this point, let us provide one example. Suppose that the regions pay each other to correct for the interjurisdictional spillover. This requires a subsidy of tax to be paid for each unit of the public good equal to the benefit (harm) received by a region from the other region's public good production. To assess the appropriate subsidy, the following information would be required by a region with respect to another: (i) the tastes of the other region in terms of how the region trades off public and private goods, (ii) the other region's production possibility frontier that incorporates the cost of public good production and (iii) the endowments of the other region (the latter pieces of information would not be required in our example of Diagram 1 as the regions are identical in this respect). To maximize the subsidy received, each region would have the incentive to reveal false data to the other region unless the regions can establish a system such that each region has no incentive to reveal false information. Such systems may be costly or impossible to implement. It may then be optimal for the regions to agree to consume the same amount of the public good.

Competition for resources by regions may also limit the ability of regions to produce different amounts of public goods. Suppose, for example, one region in carrying out its distributional policies as well as choosing its allocation of resources,<sup>14</sup> tends to tax high income individuals and capital much more than the benefit they would receive to pay for the cost of the regional public good. If the other region chooses

to produce much less of the public good, then the tax rate on high income individuals and capital would be less. Resources would migrate from the high to low tax region with wages and the return to capital falling in the low tax region relative to the high tax region. In equilibrium, one of the regions can become resource rich relative to the other.

The problem of competition of resources would be eliminated if regions only taxed individuals residing in the area for the benefit received from the public good and distributional policies were left to the central government. Then migration could lead to individuals moving to the region according to their preferences for public goods. However, if the distribution of income is a "public good" as well, then regions may have differing preferences for distributional policies which may lead to regional dissatisfaction with the central government's distributional policies. If regions implement their own distributional policies, then competition for resources will limit their ability to allocate resources between public and private sector production as they would desire.

Economies of scale may justify the central provision of a public good. For example, a country may find it cheapest to have one national defence system rather than ten provincial defence systems.

The above arguments suggest that perfect regional differentiation in the consumption of public goods may be difficult to implement. A "second-best" solution to the problem may need to be considered; regions might decide among themselves to leave the central government to produce the public good. We can now illustrate the conflict of tastes that would eventually evolve in this "second-best" world.

Suppose in Diagram 1, the central government chooses a point common to both regions on the production possibility frontier  $IJ'$  (where the central government takes into account interjurisdictional spillovers but

the regions must consume the same amount of the public good).<sup>15</sup> We might ask the question: under what circumstances would the regions be willing to remain part of the federation rather than move back to positions of autarky (C and D)? In Diagram I, any allocation of resources between public and private good production in the shaded area XYZ would be welfare improving for both regions. The regions would remain a part of the federation even if they are constrained to consume the same amount of the public good.

The shaded area XYZ is what we call the region of mutuality where given the constraints facing the regions, transactions among them would be mutually beneficial. We can see that the area XYZ shrinks in size when (i) tastes differ more (C and D points move further apart), (ii) there is less substitutability in consumption between public and private goods (indifference curves become less flat) and (iii) interjurisdictional spillovers lead to less efficiency gain (IJ' shifts out less than that shown in the diagram).<sup>16</sup>

It can also be seen that the power of the region can ultimately affect the choice of public and private good consumption as well. Suppose that the two regions choose a point on IJ' subject to a majority voting decision. If Region A is bigger than Region B then the choice of public and private good production would be closer to Point E than Point F. If the point chosen on IJ' is to the left of X (such as Point E) Region B may choose to withdraw from the federation.

In the Section III, we will discuss methods that may be used to resolve the conflict of tastes among regions. Clearly, regional differentiation of public good production would be desirable although, as suggested before, there can be limits on the ability of regions to choose different levels of public good production.

### Conflict of Claim

Conflict of claim involves friction amongst regional communities regarding distributional policies. There are two types of claim: claim with respect to a resource (i.e.: locational choice of an industry) and claim with respect to income (interregional transfers of wealth or implicit transfers associated with government interventionist policies that affect the distribution of real income among regions). In analyzing conflict of claim, we implicitly assume that a region, once agreeing to be part of a federation, may have a claim on the wealth of another region to satisfy some notion of equity as understood by the region. Of course, the notion of equity may be unique to each regional community and regions may use different principles of justice to evaluate interregional distributional policies.

There are many reasons why a relatively rich region would be willing to give wealth to a poor region. In Part III, we elaborate on these reasons but for now, we explore one of them in dealing with conflict of claim (though our results apply to all reasons why rich regions may willingly give wealth to a poor region).

We begin with a model describing the issue of conflict of claim in a federation, making a number of simplifying assumptions. First, regions have the same tastes but differ in resource endowments. Hence rich and poor regions can be identified. Second a region produces two goods, private (X) and public (Y), with a linear transformation constraint. The production of the public good involves an interjurisdictional spillover among the regions much the same as characterized in the previous discussion on conflict of taste.

In Diagram II, the problem of conflict of claim is illustrated. Consider the initial situation where there are uncorrected

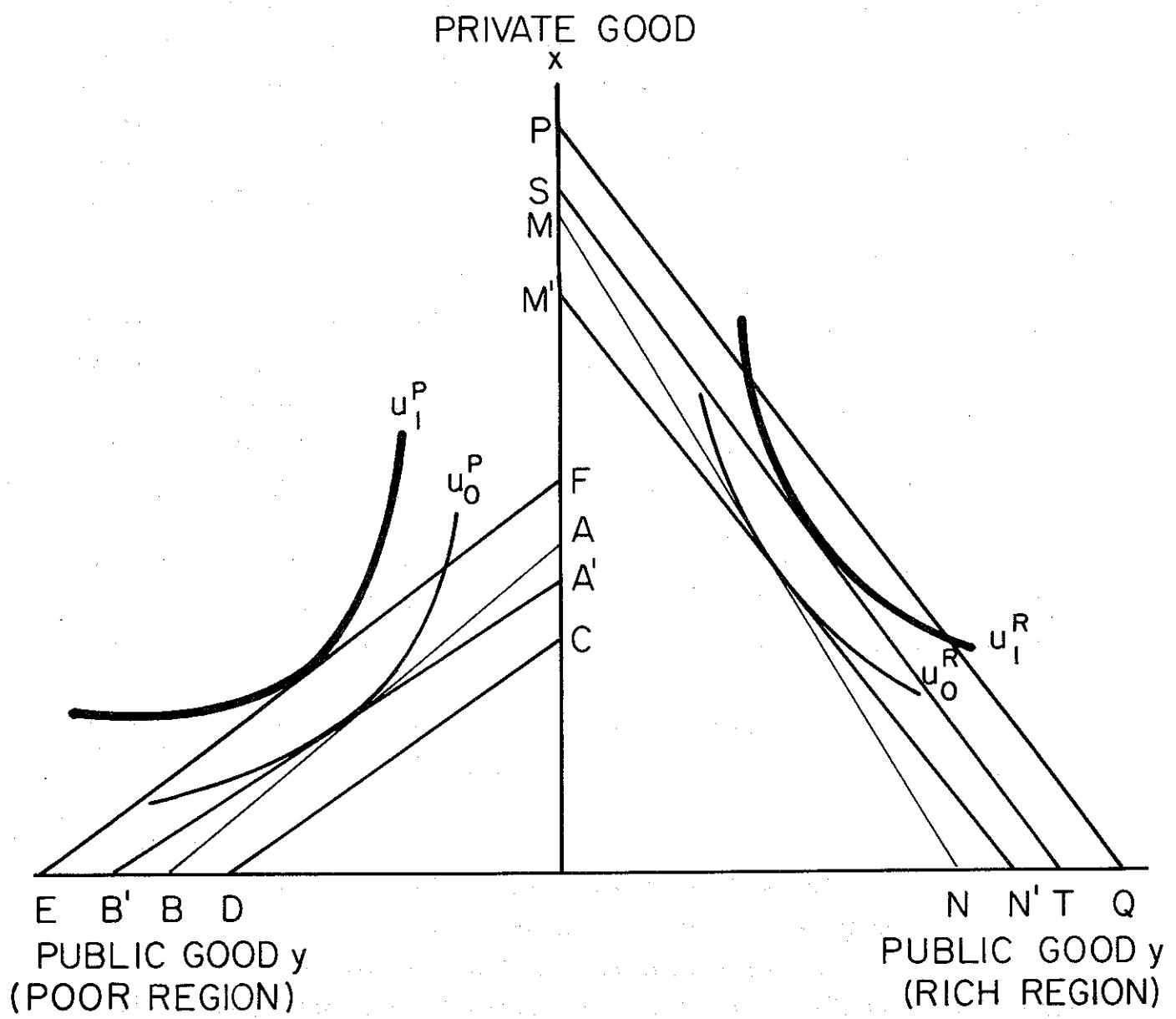
interjurisdictional spillovers between a rich region (R) and a poor region (P) and both regions do not belong to a federation. The original production possibility frontier for the poor region is AB and for the rich region MN. The initial levels of welfare for the rich and poor regions is  $U_0^P$  and  $U_0^R$  respectively. Now suppose the two regions join in a federation and correct for the public good's interjurisdictional spillover. Suppose further that there is a transfer of resources from the poor to the rich region. Without any interregional government transfers, the poor region's production possibility frontier falls from AB to CD (note the relative cost of producing the public good can fall because of the correction of interjurisdictional spillovers). The rich region benefits from the federation in that its production possibility frontier shifts from MN to PQ.

Such a federation is clearly not in the interest of the poor region unless the poor region is made better off. The rich region would be interested in such a transfer of wealth since autarky would make it worse off. Now the question can be asked, what amount of transfer of wealth would be necessary to induce each region to belong to the federation?

The minimum amount of transfer of wealth from the rich to the poor region can be derived as follows.<sup>17</sup> The poor region would be just indifferent between belonging or not to the federation if it receives money equivalent to A'C units worth of X which is equivalent to PS units of X given up by the rich region. The rich region is better off under the minimum transfer in that its level of welfare is  $U_1^R$  compared to  $U_0^R$ .

The maximum transfer of wealth from the rich to poor regions can be derived as well. The rich region would be indifferent between belonging or not to the federation if it gives up no more money than that equivalent to PM' units of X (it would then have a level of welfare  $U_0^R$ ). The poor region would receive money equal to CF(=PM') units of X and would be

DIAGRAM 2



better off by joining the federation (its level of welfare increases to  $U_1^P$  from  $U_0^P$ ).

The actual transfer of wealth between the rich and poor regions depends on the relative bargaining strengths of the two regions. A transfer between the values  $A'C$  and  $CF$  is mutually advantageous to both regions. However, there is still room for conflict regarding the ultimate value of the transfer.

The above model also develops a number of interesting implications. First, the method used in which to make transfers between regions can be important. One method is to simply transfer wealth or income between the two regions regardless of the level of public or private good production. Another is to tax the production or consumption of one good in the rich region and subsidize the production or consumption in the poor region. The first method is "lump sum", the second is "distortionary". If there are no market failures in either regional community (such as unemployed resources, taxes or subsidies on commodities or factors, monopoly pricing), then "lump sum" transfers would be the least costly method for the rich region and most beneficial to the poor region if the same amount of benefit transferred to the poor region is desired. On the other hand, if there are market failures in one or both regional communities then a transfer which is distortionary can be viewed as either beneficial or harmful to either one or both of the regions.

Consider the following example. Suppose that the rich region owns a resource, oil, which is consumed by the rich region or sold to the poor region. The poor region uses oil to produce a private good and there is unemployment in the private industry. The poor region does not care if it receives money in lump sum form or as a subsidy on the price of oil since it would subsidize oil anyway. The rich region would prefer to make a lump sum transfer although the only possible transfer perhaps is by taxing oil

in the rich region. Then a distortionary tax on oil makes the transfer more costly to the rich region. The rich region would be willing to give up his income to the poor region — the maximum transfer to be paid to the poor region falls.

The efficiency gains of a federation are related to the minimum amount of subsidy required by the poor region and the maximum amount of subsidy paid by the rich region. The more that the rich region gains from creating a federation the greater the maximum transfer possible before the rich region withdraws. The less that a poor region is hurt from joining a federation the smaller the minimum transfer required to keep the poor region as part of the federation. There is a widening of the difference between maximum and minimum amounts of subsidies however and this creates a greater possibility of conflict at the bargaining stage (once the principle of a transfer is accepted). Moreover there is a difference between the situations when a poor region gains rather than loses (as we have just discussed) from a federation. If the poor region gains, then the minimum subsidy is negative. While the difference between maximum and minimum subsidies is greater, the poor region loses some bargaining power since it clearly benefits without a subsidy in staying in the federation.

The size of region is important. As pointed out by May<sup>18</sup>, stable federations tend to be those where relatively rich densely populated regions subsidize poor less populated regions, while federations tend to be unstable if the converse is true. If the rich region is small in population, for example, then a larger grant per person in a rich region is required to make per capita income the same in a poor region. If we considered the indifference maps and production possibility frontiers of Diagram II to be those of the representative regional individual, then it can be seen that a grant on a per capita basis to a poor region would require a large per capita reduction in resources in the rich region. If the poor region is heavily populated then the rich region may choose not

to be part of the federation as the minimum per capita grant made to the poor region may be too demanding.

The above discussion of conflict of claim is unlike conflict of taste in one instance. Under conflict of taste, there exists a "best" solution in which regions may resolve the conflict totally. With conflict of claim, there is no unique "best" solution. Conflict is inherent in the problem as regions haggle over the appropriate transfer to be made. The conflict of claim arises from the situation that no one region has the right to determine the distribution of wealth and resources in a federation. Even if one were to leave the decision to the central government, the question still remains: how much should each region get?

### 3 MANAGING CONFLICTS OF TASTE AND CONFLICTS OF CLAIM

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We examine now some institutional mechanisms for managing conflicts of taste and conflicts of claim and ask about the prerequisites for dealing with them. We focus on the implication of three distinct institutional mechanisms for the two classes of conflict. First are mechanisms in which the responsibility for the provision of the public good is centralized; second those where decisions are decentralized to the region; and third those in which decisions are made intergovernmentally, through bargaining among provinces.

Each mechanism will have consequences for the bargaining power of different regions; institutional rules are not neutral. Let us look first at the management of conflicts of taste.

#### Conflict of Taste

What, to begin, would be the effects of a centralized regime? If differences in taste are small or non-existent, then there is no conflict between majorities within each region or between any regional majority and the country-wide majority. There may of course be large differences across other lines of cleavage, such as class. In this case, centralization will not frustrate any regional majority.<sup>19</sup>

Even where differences in taste are small, however, the lesson need not always be centralist. Citizens may have a preference for which government, local or national, provides the public good. It may be preferable that an authority be seen as close and responsive even if its policies are no different from those made by a more distant authority. There may be diseconomies of scale in some policy areas, especially in managing public services, which suggest decentralization might be more efficient. In general, with no sharp regional differences in opinion, decisions about the allocation of responsibilities can be made largely on cost efficiency grounds alone.

If tastes vary widely from region to region, centralization is likely to lead to the frustration of regional majorities. The will of the national majority is likely to be incompatible with one or more regions. Regional majorities will be forced to accept a level or quality of public services they do not wish. Or the local majority can be frustrated because the national one vetoes its proposals. The more the central government operates according to the principle of majority rule, the greater the likelihood of minority frustration. If the same regional majorities are frustrated over a wide range of issues, or over a long period of time, the incentive to opt-out increases.

If the majority rule principle is relaxed to a more consensual decision rule, central policy may then be a compromise among the relevant regional preferences. It is still however, the case that no one regional majority will have got all it wished, something which may be possible with decentralization.

It is also possible that the central government may itself produce regionally differentiated public goods, modifying its policies to suit different regional interests. But regional majorities still remain subject to the overriding control of the national majority. A government

responsive to the minority interest today may not be tomorrow. One can only be certain of favourable policy if one has control. So this solution is, under most circumstances, unappealing to provincial interests.

Decentralization presents the reverse situation. Where regional differences in taste are small, decentralization may impose additional decision-making and administrative costs which lead to frustration of both regional and national majorities.<sup>20</sup> This was the overwhelming criticism of federalism by writers in the 1930s. In other cases, however, decentralization may still be consistent with homogeneous national policy, since each regional majority will demand the same pattern of public policy and the same level of service will be provided in each province.

Decentralization is the obvious solution where there exist sharp regional differences in taste. Each local majority can then enact what it wishes without needing to secure the consent of majorities in other provinces. But this ideal solution, in fact, only works well under some conditions.

Several kinds of constraints may operate on local governments' ability to enact their preferences. The first is fiscal capacity. For a poor region, freedom to enact one's preferences in public policy is nugatory if it can only be done by sacrificing other goods including private goods which are essential to the survival of its citizens. The ability of the region to provide public goods such as a good educational system may require substantial tax rates on the poorest of its citizens. Hence, where the fiscal capacities of provinces differ, then freedom to enact different preferences depends on an element of claim; specifically on some form of equalization.

The second constraint depends on the mobility of factors. If a given province wishes to enact a relatively progressive social policy it may

find that wealthy residents leave and larger numbers of the poor move in. The latter may be solved through residence requirements; but the former may be harder to deal with. Similar difficulties arise in other spheres. For example, a province wishing to prohibit extra-billing in medicare may find its doctors moving to other jurisdictions which do permit the practice. Thus even without central government direct intervention, jurisdictions may find their ability to pursue their distinct preferences limited and this is likely to be a strong stimulus to policy similarity across jurisdictions. Similarly, if the preference is for rapid economic growth, provinces may find themselves in competition with others in terms of regulatory regimes, tax systems and the like.

As noted earlier, spillovers too may lead to negotiation amongst regions over their incidence and the methods for compensation. Thus differences of taste are likely to translate quickly into competing claims to the extent that factors are mobile between provinces, that there are unequal resource endowments among them, or that there are large spillovers.

This suggests that even where there exist preference differences there is a role either for cooperative arrangements among provinces to harmonize policies or for a central government which, through equalization and mobility policies, will sustain the conditions for effective choice among provinces.

Thus complete disengagement is not often possible. This suggests two quite different motivations for development of cooperative intergovernmental arrangements. On the one hand they have developed historically, as in various conditional grant programs in social welfare, in order to overcome the difficulties of provincial jurisdiction where there has been a broad national consensus in which common preferences in taste have not been matched by centralized authority. But they are also necessary in order to provide the conditions under which jurisdictions are

effectively able to pursue their own preferences; they are a condition of diversity as well as similarity.

An additional group of conflicts of taste cannot be solved by decentralization. These involve goods which by their nature are indivisible and which have little meaning unless applied to the country as a whole. Examples are symbolic questions such as a flag or retention of the monarchy. Provinces can, of course, have their own flags; in principle a province might even be permitted to choose for itself whether it wanted to adhere to the monarchy. But at the level of the national government, it must be one or the other.

#### Conflict of Claim

Conflicts of claim are much more difficult to regulate than conflicts of taste because by definition they involve direct competition and exchange between jurisdictions. The quality of such exchanges — their perceived fairness — is crucial. We must therefore look at the bargaining power available to different regions as they participate in them.

How do claims become established? Why not act as individual units which owe nothing to each other? For claim is based on a balance between two different kinds of forces. Without some degree of association, conflicts of claim would not arise, except as problems in international relations; it is because regions are tied together in a wider political unit that conflict of claim becomes a political issue. On the other hand, without distinct regional identities, conflicts of claim would not exist either.

One motivation for dealing with claims between regions is altruism. A wealthy region would accept some responsibility to share its wealth or accept policies which confer differential benefits on regions as part of a general commitment to maintain the national political community.

Citizens of richer provinces would perceive an obligation owed to the poorer by virtue of their sharing membership in the same community. Poorer regions would similarly base their claims on the moral obligations which arise from community.

A rich province may agree to transfer its present wealth as insurance against a possible future change in its status. A resource-dependent province, subject to wide swings between boom and bust may be willing to share more in good times in return for assurance of protection in the bad.

A third motivation is that redistribution may be a necessary inducement for regions to remain in a federation. Where the benefits of association are small, where "going it alone" would be more advantageous, to accept redistribution depends on the weaker reed of altruism. This explains a difference between Ontario and Alberta: the former may have accepted redistribution more easily because it depends much more on Canadian markets and is more obviously a "beneficiary" of Confederation than the latter.<sup>21</sup> In addition a large proportion of the transfers from Ontario to poorer provinces is likely to find its way back to the province in the form of purchases of goods and services. By contrast, Alberta, except for oil and gas, trades little with Ontario — and in the case of oil and gas it is forced to sell at a much lower price than it could obtain elsewhere. To add insult to injury, to the extent Alberta does buy goods from Ontario, tariff protection means it must pay more than prices on the world market. Thus, redistribution from Alberta to Ontario (and other consuming provinces) has a quite different political impact than transfers from Ontario to other provinces.

In general, the greater the level of mutually reinforcing economic linkages among regions, the greater the incentive to compromise competing claims. The fewer such linkages, the fewer the incentives. The wider the

variety of interregional exchanges, the more likely they will provide positive benefits to all.

Provinces enter conflicts of claim with differing interests and different levels of bargaining power. We discuss these in terms of wealth and relative size.

The bargaining power each unit brings to the exchange depends in part on the decision rules. One important aspect of these rules is how they weigh the question of size. It is especially crucial when units vary as widely in population as they do in Canada. Perhaps the most important distinction among the institutional forms for dealing with conflicts of claim concern how to treat size and the extent to which units are treated equally regardless of population.

Let us look first at centralization as a method for dealing with conflict of claim. In some ways, an overarching centralized authority seems best equipped to deal with distributional conflicts among regions. Indeed Usher argues that only the central government is equipped to deal with distributional policies, both inter- and intra-regionionally,<sup>21</sup> since only it can encompass both richer and poorer areas and internalize mobility between regions. Without the central government it is impossible for poorer regions to establish a direct claim to the wealth of richer regions. Similarly, the central authority can regulate the terms of competition among regions which individual units may be unable to do either because of greatly different abilities to play the competitive game or because without an umpire each will have an incentive to undercut any agreed rules.

But the advantages and disadvantages of centralization look very different from the vantage points of different provinces. Their assessments depend on perceptions of whose interests the central

government is most likely to serve. It is unlikely to be a neutral arbiter or umpire. The contradiction between national majority rule and minority regional interests can become acute.

If the centre operates according to majority rule, then a large poorer province has an incentive to opt for centralization. Its population knows that under most circumstances it will be able to exert great influence there and that through central policies it can establish claims to other provinces' resources which it could not do through interprovincial bargaining.

A large wealthy province can probably protect its interests within a centralized regime but will still fear that the federal government will extract resources from it. Thus, in the post-war period, Ontario was a consistent advocate of a greater share of tax revenues for the provinces and warned against "killing the goose that lays the golden eggs." But more recently, with its relative shift in economic position, Ontario has advocated a strong central government in the constitutional and energy debates.

A smaller claimant province may also opt for a centralist strategy even if it can only exercise limited influence there. It may still be able to be part of a winning coalition and in any case can establish a claim indirectly through Ottawa which it could not do otherwise. A poor province does not want to protect its advantages; it wants to gain from redistribution.

The situation is entirely different for a small, rich province. It has little bargaining power to prevent the central government from extracting resources, or to limit its ability to utilize these resources in order to promote growth in other areas. This weakness would not be a problem where there are other, larger provinces with similar interests with which it

could form a majority coalition in Ottawa. Such, of course, has not been the case recently for Alberta in Ottawa. The clear interest of such a province is for decentralization of policies with respect to claim and clear limits on the power of the central government. This explains Alberta's interest in ensuring that its jurisdiction over resources is protected from invasion by any kind of national majority and its constitutional emphasis on Canada as a compact among provinces, irrespective of size.<sup>23</sup>

Centralized authority with respect to claim may itself vary in responsiveness to various kinds of interest. The majority need not always insist on prevailing. The majority rule principle may be modified to weigh various minorities more heavily even within the centre, for example, through formal or informal rules for concurrent majorities or through a bicameral legislature based on equal representation of units. Practices of "proportionality" in countries like Austria and Switzerland or those which emphasize the need for unanimity rather than simple majorities may reduce the sense that the central authority is the agent of the larger units.<sup>24</sup> Alienation of a small region is systematically greater the more it feels itself to be the loser on issue after issue over long period of time. One problem of cabinet government based on the British model is that it is predicated on the notion that, once in power, there are few restraints on majority power. For these reasons, as conflicts of claim grow, so does consideration of "intra-state" federalism solutions — those which like a "House of Provinces," build state or regional interests into the structure of the central government, and weight small units disproportionately.

The strengths and weaknesses of decentralization with respect to claim are the converse of those just discussed. Small rich provinces are able to protect their resources and share on their own terms. Large rich provinces may also opt for decentralization, but centralization poses few

real threats to them and may offer the advantage of being able to block retaliatory policies from other provinces. Neither large nor small poor provinces have anything to gain from decentralization.

If conflicts of claim are to be negotiated at all under decentralization there must be bargaining, this time among unit governments rather than within the central government. How are conflicts of claim likely to be dealt with through an intergovernmental mechanism? Its success depends on the voluntary participation of all units; that, in turn, means that it depends overwhelmingly on each believing it has something to gain, that there are real advantages to engaging in the exchange. Without a common core of underlying linkages and a sense that in the long run, redistribution benefits both donor and recipient, it can get nowhere.

One disadvantage of the confederal model may be that the participants in it become preoccupied with defending their regional interests and extracting the most from the exchange so that the benefits for all become obscured or forgotten. No participant has a vested interest in the welfare of the system as a whole; none has a strong incentive to search out and explore beneficial linkages. Moreover, competition for authority and prestige among politicians is added to and accentuates the underlying regional conflicts of claim. Governments may have an interest in maintaining population and hence resist adjustment mechanisms which result in population shifts.

A related problem is the difficulty of arriving at a decision rule among governments. If it is unanimity, then the process is subject to what the most reluctant participant is willing to give. The poor region with little to offer in return for sharing is in a very weak position. Claimant provinces are therefore likely to argue for agreement of only a majority of provinces; those on whom claims are being made will opt for unanimity.

A voting rule also reintroduces the problem of weighting the votes. To weight them proportionately to population is to recall many of the problems with central authority. Indeed, they could well be accentuated since the confederal mechanism treats each province as a homogeneous unit whereas a central government's unit membership is likely to be divided among several parties with different interests.

Thus each major institutional mechanism for dealing with conflicts of claim seems to have serious weaknesses. Central authority raises the possibility of large dominant regions exercising control over the smaller ones without providing compensating or proportional benefits. Decentralization and confederalism protect the small and the privileged.

From the provincial viewpoint, the clearest interests are those of the large poor provinces which have an incentive to seek centralization and of the small rich provinces which benefit from decentralization. More ambiguous are the interests of the small and poor and the rich and large. The former would probably cast their lot with centralization and would benefit especially from a bicameral legislature with one House weighting provinces equally, thus strengthening their bargaining power. The rich large province is likely to be ambivalent, seeking to limit claims on its resources (through decentralization), but also wishing to use its power at the centre to shape economic patterns to its advantage.

#### 4 CONCLUSION

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This analysis has underlined the importance of two distinct classes of conflict or disagreement in federal systems. It has shown how they pose distinct problems and have quite different implications for thinking about mechanisms of conflict resolution. Too much analysis of "regionalism" in Canada has emphasized cultural and attitudinal differences associated with conflicts of taste. While these are no doubt important, they should pose few problems for constitutional designers. Unlike conflicts of claim, they can be solved by the constitutional division of powers.

While much of the literature on federalism has concentrated on conflict of taste, we wish to emphasize the importance of conflict of claim especially in contemporary Canada. Issues are defined in terms of rival claims to wealth and political power both interregionally and intergovernmentally. Calculations are cast in terms of "winning or losing" from the Confederation bargain and from the actions of the federal government. While such conflicts are as old as Confederation, they appear to have intensified greatly in recent years and to have become generalized into sharply competing ideologies of the structure of the federal system itself.<sup>25</sup> In turn, conflicts which do not at first sight seem to be necessarily "regional" become defined in the regional context. Even debate about purchase of a jet fighter plane was based in part on where the associated "industrial off-set" activities would take place.

The reasons for this intensification are complex and it is not necessary to examine them in detail here. A few factors may be mentioned, however. First, as we have mentioned, it is possible that convergence in tastes leads to increased conflicts of claim. The reason for this apparent paradox is that where tastes differ greatly, groups if left alone can simply by-pass each other. But where they are the same they compete, as it were, on the same terrain. As Quebec modernized in the 1960's the disparity in access to positions of power in industrial society became more repugnant. Quebecers aspired to these positions and found them occupied by Anglophones. The historic division of labour in which English Canadians controlled the economy and French Canadians controlled their cultural life had broken down. Similarly Ontario and Alberta compete not because they want different things but because they want the same things.

Second, conflict of claim is increased as the disparities in wealth or resources increase. The rich then have more to lose, the poor have more to gain. The poor have fewer opportunities to offer compensation. Conflict of claim is also increased the more the rich provinces are small and the poor provinces are large and the greater are these size differences. In this case, the greater the redistribution per capita from the small province to produce a given reduction in disparities. Moreover, the greater will be the temptation of the larger provinces to use their majority to extract benefits from the rich and the more the sense of threat and persecution on the part of the small.

Third, the fewer the linkages among regions in trade the more intractable conflicts of claim. Without such linkages growth in one region is unlikely to spill-over to benefit other parts of the country. The less the ability to provide compensating trade-offs the more exchanges are seen to be zero-sum. The nature and distribution of Canadian resources combined with patterns of trade and ownership of industry appear to greatly limit the possibility of building mutually reinforcing linkages. Such linkages

as there appear in many cases to be coerced and artificial rather than growing out of natural advantages.

Fourth, the increased role of government implies that economic relationships among regions are less likely to be seen as the result of the working out of impersonal market forces; they are more likely to be seen both as the result of discriminatory government policies and so subject to governmental redress. Conflict of claim cannot be eliminated through an "efficient" distribution of powers or through maximizing aggregate levels of welfare since that says nothing about the regional distribution of benefits. It is predicated on a divergence rather than a complementarity of interests. This suggests that any analysis of outcomes of conflicts of claim must focus on power, influence and coercion — on the bargaining power which regional actors are able to bring to bear. Alternative institutional mechanisms are thus judged by different regions in terms of the weight they give the region, whether to enable it to gain access to others' resources or to protect its own. These are the fundamental issues in constitutional debates over majority rule versus minority rights, over the constitutional treatment of natural resources and over formulae for constitutional amendment. They are also at the heart of the problem of majority rule in a federal system — since federalism specifies two kinds of majorities, national and regional. There are few principles for deciding which should prevail in any given case.

This is not to assert that conflicts of taste have disappeared. They remain in two forms. First, there are undoubtedly differences in preference, especially with respect to "cultural" issues like bilingualism. Second, arguments based on diversity of preferences may seem to appear more legitimate in political debate than outright assertions of claim. Hence conflicts of claim are often cloaked in the language and rhetoric of taste.

Once regional identities have formed, however, it seems an essential condition of the maintenance of the system that over the long run, all regions must feel that they are not systematically coerced and that there is a reasonable balance between wins and losses, whatever the institutional structure. If the overall responsibility is centralized, this requires two conditions: that each region feel itself to have a voice in the decisions made by the central government through representation in its governing councils and that the government ensure a mix of benefits across regions even if that implies a departure from strict application of majority rule. If the distributive decisions are to be made confederally, there must equally be some departure from the rule of unanimity and each province of itself.

None of these conditions can be created by institutional tinkering alone. They depend ultimately on the regions, however represented, having a strong incentive to stay in the federation. Integration ultimately depends, therefore, not only on the volume and complexity of the interchanges among regions but also on what we call mutuality, the extent to which the benefits of exchange are mutually advantageous. That implies the need for economists and political scientists to look not only at institutions and intergovernmental relations but also to probe below the surface to other economic, social and organizational relationships within which regions meet.

## NOTES

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- 1 We are indebted to David Wilson for carrying out a detailed analysis of the literature on economic and political integration which underlies much of this paper.
- 2 D. V. Smiley, "The Rowell-Sirois Report, Provincial Autonomy and Post-War Canadian Federalism." *Canadian Journal of Economics and Political Science* 28 (1962), 54-69. p. 57.
- 3 Task Force on Canadian Unity, *A Future Together* (Ottawa: 1979), p. 41.
- 4 *Ibid.*, p. 26.
- 5 This lay at the heart of the "battle of the balance sheets," between Quebec and Ottawa in 1976-77. See P.M. Leslie and Richard Simeon, "The Battle of the Balance Sheets," in Simeon, ed. *Must Canada Fail?* (Montreal: 1976) pp. 243-258 and citations listed there.
- 6 See Richard Simeon and Donald E. Blake, "Regional Preferences: Citizens' Views of Public Policy," in D. E. Elkins and R. Simeon, *Small Worlds: Provinces and Parties in Canadian Political Life* (Toronto: 1980), pp. 77-105.
- 7 Roger Gibbins, *Politics and Society: Regionalism in Decline* (Toronto: 1980).
- 8 There are two notions of equity: (i) vertical equity which may be defined as government tax and expenditure policies that treat unlike individuals in a different manner (i.e.: to improve the distribution of income) and (ii) horizontal equity which may be defined as government policies that treat alike individuals in the same manner. "Efficiency" is the state that no one individual can be made better off in terms of his welfare without making someone else worse off (a representative individual achieves his highest level of welfare possible given the distribution of wealth).

- 9 In the normal paradigm used by welfare economists, the central planner has the ability to make allocative and distributional decisions freely to maximize social welfare (which may be defined over the welfare levels of individuals). Individuals cannot withdraw from the community if they do not like distributional policies although such a constraint can be incorporated in the planner's problem. It is the implications of individual's ability to withdraw which is of interest to us.
- 10 We assume the normal properties of the utility function: quasi-concavity, continuity, and nonsatiation.
- 11 Robin Broadway *Public Sector Economics* (Cambridge, Mass., 1979) and Richard Musgrave *The Theory of Public Finance* (New York: 1959).
- 12 We assume here that the public good is normal.
- 13 In actual fact, the production possibility frontier can shift more for the region producing less of the public good compared to the other region because public good production differs in each region. Moreover, if subsidies are paid for production in one region then taxes from both must be raised, again altering the position of the production possibility frontiers. We ignore this effect by assuming  $l_1'$  is the same in both regions.
- 14 In the original Tiebout model (1956), there is benefit taxation in that only individuals who benefit from local public goods pay for the public good.
- 15 Again, as discussed in footnote 10, the production possibility frontier would shift from  $l_1'$  as public good production in each region changes (in this use, however, the production possibility frontiers move to be identical). For simplicity we ignore these changes.
- 16 This is similar to the surplus concept used by Judith Maxwell and Caroline Pestieau *Economic Realities of Contemporary Confederation* (Montreal: 1980).
- 17 Here we assume "lump sum" transfers are made in that that transfer does not affect relative prices (only wealth or income effects are experienced).
- 18 R.J. May, *Federalism and Fiscal Adjustment* (Oxford: 1969).
- 19 Class and regional cleavages may of course overlap. For example, in C.B. Macpherson's analysis in *Democracy in Alberta* (Toronto: 1962), shows how Alberta-Ottawa conflict could be seen as that between a single-class, agricultural petite-bourgeoisie against Central Canadian finance capital.

- 20 This was the situation which preoccupied students of federalism during the depression. See, for example, J. R. Mallory, *Social Credit and the Federal Power in Canada* (Toronto: 1954).
- 21 Data on patterns of interprovincial trade is very weak and focussed almost entirely on trade in manufactured goods. See *Interprovincial Trade Flows, Employment and the Tariff in Canada, Supplementary Material to the 1977 Ontario Budget* (Toronto: 1977).
- 22 Dan Usher "How Should the Redistributive Power of the State be Divided Between Federal and Provincial Governments" *Canadian Public Policy* VI (Winter: 1980) pp. 16-29.
- 23 For an analysis of provincial constitutional options from this perspective, see Alan Cairns, "Constitution-Making, Government Self Interest, and the Problem of Legitimacy in Canada," mimeo. 1981.
- 24 See Kenneth McKae, ed. *Consociational Democracy* (Toronto: 1970), *passim*.
- 25 For a review of these as manifested in recent debates see Ronald Zukowsky, *Struggle over the Constitution* Vol. II, *Intergovernmental Relations, the Year in Review, 1980* (Kingston: Institute of Intergovernmental Relations: 1981). See also Richard Simeon and Jeff Evenson "The Roots of Discontent" in *The Political Economy of Confederation* (Kingston and Ottawa: 1978), pp. 165-196.

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